OVERSIGHT HEARINGS INTO THE EFFECTIVENESS OF FEDERAL BANK REGULATION

(Federal Home Loan Bank Board's Supervision of Washington Federal Savings & Loan Association)

HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

NINETY-FOURTH CONGRESS

SECOND SESSION

JANUARY 16 AND MARCH 11, 1976

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OVERSIGHT HEARINGS INTO THE EFFECTIVENESS OF FEDERAL BANK REGULATION

(Federal Home Loan Bank Board's Supervision of Washington Federal Savings & Loan Association)

FRIDAY, JANUARY 16, 1976

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER,
AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
New York, N.Y.

The subcommittee met, pursuant to notice, at 9:30 a.m., in the appellate courtroom of the U.S. Customs Court, 1 Federal Plaza, New York City, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Robert F. Drinan, Edward Mezvinsky, and Garry Brown.

Also present: Ronald A. Klempner, counsel; Robert H. Dugger, economist; and Lawrence T. Graham, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN ROSENTHAL

Mr. ROSENTHAL. Today's hearing by the Commerce, Consumer, and Monetary Affairs Subcommittee is the first in a series of hearings investigating the effectiveness of the examination functions of the Federal bank regulatory agencies. These agencies—the Federal Reserve System, Comptroller of the Currency, Federal Home Loan Bank Board and Federal Deposit Insurance Corporation—regulate almost 20,000 institutions with assets aggregating over a trillion dollars. They are probably the most important and least scrutinized regulatory agencies in Washington. While their mission goes to the very foundation of our economic system, they have operated under what I regard as an unwarranted cloak of secrecy. If recent events have taught us anything, it is that excessive secrecy in Government agencies leads inevitably to governmental inefficiency and abuse.

Governor Jeffrey Bucher of the Federal Reserve Board, in describing how the U.S. system of bank regulation fails to serve the public interest, recently said, and I quote, "In the first half of the 1970's, by depending more and more for funds on increasingly volatile liabilities, many banks were caught short when, for reasons that probably should have been anticipated, sources of funds were shut off. These events and a number of jarring domestic bank failures have resulted in the

growth of skepticism about bank regulators, who the public thought were keeping banks from doing imprudent things."

He continues, "I think what needs restoration in the present environment even more than the confidence in bank management is confidence in the dependability and practicality of bank regulations and supervision."

Dr. Arthur Burns, Chairman of the Federal Reserve Board, has termed the bank regulatory system "exceedingly complex, fostering a competition in laxity as regulators are played off against one another by banks with power to choose their regulators."

The fundamental issue to be dealt with by this subcommittee is whether the examination procedure and practices of the banking agencies are adequate. We will approach this important question by focusing very closely on selected loan transactions that are known to be representative of hundreds of troubled real estate loans now in the portfolios of banks and savings and loan associations across the country.

The subcommittee will review the Federal Home Loan Bank Board's examination practices, its supervision of Washington Federal Savings and Loan Association of New York, and its evaluation of various loan transactions of that institution. These include a $5 million loan for the construction of Village Mall Townhouses and two loans to Dr. Bernard Bergman, a nursing home operator.

The Village Mall project, a 141-unit condominium complex in Bayside, Queens, was only 50 percent completed when construction halted 1½ years ago and over $600,000 in downpayments from individual unit purchasers, has yet to be returned.

The Village Mall loan and other practices of Washington Federal, and the way in which the Home Loan Board has supervised the association's operations, should provide some insight into the adequacy of regulation by Federal banking agencies.

Additionally, over $11 billion has been invested in real estate investment trusts during the past decade by banks, and a greater amount in seemingly glamorous real estate construction and development projects, many of which are now in default. The threat to bank solvency and loss of capital resulting from the billions of dollars invested in assets which can no longer meet the principal or interest payments impedes economic recovery and contributes to the high rate of interest which burdens all borrowers.

Moreover, the immediate hardships suffered by those families whose savings may be lost because of unsound real estate development and construction supported by banks, adds a personal dimension to the grave problems caused by ineffective Federal bank regulation.

I do want to say a note of appreciation and thanks to my colleagues who have taken time out during this recess period to attend this important meeting in New York City. In view of the fact that this meeting is being held out of Washington, D.C., I do want to publicly acknowledge their presence—Congressman Garry Brown of Michigan, Congressman Robert Drinan of Massachusetts, and Congress Ed Mezvinsky of Iowa.

Our witnesses this morning are Mr. Bryce Curry, president of the Federal Home Loan Bank of New York, who is accompanied by Mr. Dan Goldberg, Deputy General Counsel of the Federal Home Loan

Bank Board; Mr. Jerome Plapinger, Associate General Counsel of the Federal Home Loan Bank Board; Mr. Robert Moore, Deputy Director, Office of Examinations and Supervision of the Federal Home Loan Bank Board; Mr. Frank Passarelli, Associate Deputy Director of the Office of Examinations and Supervision of the Federal Home Loan Bank Board; Mr. Harold Puchalsky, senior vice president, Federal Home Loan Bank of New York, and Mr. Vincent Cerreta, Field Manager, Federal Home Loan Bank Board.

Mr. Curry, you have a rather lengthy prepared statement. We appreciate the fact that you complied with the rules of the House and provided us with advance copies and we would be pleased to hear it.

STATEMENT OF BRYCE CURRY, PRESIDENT, FEDERAL HOME LOAN BANK OF NEW YORK; ACCOMPANIED BY HAROLD PUCHALSKY, SENIOR VICE PRESIDENT; DAN GOLDBERG, DEPUTY GENERAL COUNSEL, FEDERAL HOME LOAN BANK BOARD; JEROME PLAPINGER, ASSOCIATE GENERAL COUNSEL; ROBERT MOORE, DEPUTY DIRECTOR, OFFICE OF EXAMINATIONS AND SUPERVISION; FRANK PASSARELLI, ASSOCIATE DEPUTY DIRECTOR, OFFICE OF EXAMINATIONS AND SUPERVISION; AND VINCENT CERRETA, FIELD MANAGER

Mr. CURRY. Mr. Chairman, I have a condensed statement. I will be happy to read either statement.

Mr. ROSENTHAL. Without objection, the full text of your statement will be included in the record.

[See p. 54.]

Mr. ROSENTHAL. We would be very pleased to hear the condensed version on condition that you move the mike 3 or 4 inches closer.

Mr. CURRY. For the record, Mr. Chairman, my name is Bryce Curry. My major responsibilities are as president of the Federal Home Loan Bank of New York which is, as you know, a reserve credit institution for the member institutions.

In addition to that responsibility, I act as one of the advisers to the Federal Home Loan Bank Board. Certain officers of the bank have been designated as the Board's agents for the purpose of supervision.

Mr. Harold Puchalsky who is a senior vice president of the bank is on my far right. I am also accompanied by Mr. Dan Goldberg who is Deputy General Counsel, Mr. Jerome Plapinger, Associate General Counsel, and Mr. Vincent Cerreta, who is involved in the examining process.

We do appreciate this opportunity, Mr. Chairman, to comment and try to be responsive to the questions which have been propounded.

I would like to say at the outset that we and the Federal Home Loan Bank Board have cooperated fully with the committee in making anything we have available to your staff.

Mr. ROSENTHAL. That is absolutely correct. For that we are enormously grateful.

Mr. CURRY. The Board is the Federal regulatory and examining authority for Federal savings and loan associations. The Board also is the

operating head of the Federal Savings and Loan Insurance Corporation which insures savings accounts associations which qualify for account insurance. The Board also oversees the operations of the Federal Home Loan Bank system, the 12 regional banks.

Under the Board's governing regulation, a Federal association—and I am taking this up, Mr. Chairman, in order of the major statement which we furnish the committee—a Federal association is permitted to establish a branch office if it demonstrates that there is a need for a proposed branch in a community to be served by that branch, that there is a reasonable probability of usefulness and success of the proposed branch, and the Board finds that the proposed branch can be established without undue injury to existing thrift institutions.

In addition, the Board will not approve branch applications of Federal associations with serious supervisory problems which management appears unable or unwilling to correct, or those with substantial financial difficulty, unless the difficulties are of such a nature that the granting of the branch might aid in the remedy of those difficulties.

We do take supervisory objection to a branch application where it appears that the applicant lacks the required managerial resources to successfully staff and operate additional branch offices.

For the past several years, it has been the policy of the Board to encourage Federal associations to establish branch offices. The Board has concluded that through the opening of branch offices in local neighborhoods and other locations convenient to the public, the Federal association will be able to meet the needs of the public and to achieve the objective of promoting thrift, savings, and so on.

The Board's role as the regulator of insured savings and loan associations is one of fashioning and implementing a comprehensive regulatory scheme to guide such institutions in their dual function of providing safe depositories for the public's savings and providing adequate funds to meet the Nation's housing needs. Through its Office of Examinations and Supervision and the supervisory agents, the Board determines the extent of adherence to safe and sound operations, and attempts when there is a breakdown to obtain corrective measures.

The Board's philosophy of regulation is a simple and basic one. It believes that those regulations and policy guidelines should be enforced that are necessary to insure safe and sound operations. The Board is aware that regulatory controls should not unnecessarily restrict or interfere with basic free enterprise. It recognizes that there are limits on its regulatory authority, that the association's management and not the Board is responsible for making most of the business decisions with respect to individual transactions.

To accomplish any regulatory examining or supervisory objectives that are designed to insure zero bad loans would have to be an effort of such a magnitude that it would seriously impede, in my judgment, the public policy objectives of financing shelter for the American people.

What the Board does attempt to achieve is a balance between housing needs and the obvious requirement that institutions under its jurisdiction operate in a safe and sound manner.

The Board acts by the establishment of regulations to guide associations, by monitoring and factfinding through the examination process, and by correcting abuses through the supervisory process.

The Board considers the examination process to be essentially a continuous one. Periodically, examiners make in-depth reviews of institutions under the Board's jurisdiction. The product of these reviews or examination, the examination report, serves as the basis for obtaining correction of regulatory violations and of unsafe or unsound practices.

Now, certain institutions pursue policies and procedures that constitute unsafe practices. We initiate remedial supervisory actions to obtain correction. I might say that generally how this works is a rather "tough" supervisory letter to the institution and to its management, its board of directors, pointing out the things which we think constitute practices which should not be tolerated. In most cases, that process brings about a satisfactory correction.

Now, if that does not work, then we move on to the next step which becomes progressively stronger. We bring in, for example, the board of directors and discuss the examination report and operating ratios in great detail. We seek to obtain assurances of certain actions to bring the institution back to an acceptable level.

If we are still unsuccessful, we would institute cease-and-desist proceedings, and of course, the ultimate remedy which can be taken only in accordance with statutory authority, is to place a conservator in the institution.

While the overwhelming majority of insured institutions are operating in a satisfactory manner, there are institutions which are currently of substantial supervisory concern to the Federal Home Loan Bank Board, and certainly, in this bank district, of concern to us. These are institutions which we have rated in the No. "3" or No. "4" category.

And I might say, Mr. Chairman, commencing on page 11 of the statement we have filed with the committee, those different categories are defined. However, I will be glad to explain any of that information.

When an institution is in either a 3 or 4 category, it comes under much closer supervisory control. It means that we have to act very promptly. In case any institution falls into category 3, it is mandatory that we call the board of directors in and begin to have some very "tough" conversations.

Now, there is a further categorization which the Board calls the problem list. It is usually made up of institutions in the 4 category. It may include 3's. And I can conceive of a situation where institutions of higher ratings may be included. For example, if you had a very substantial deterioration since the last examination, even though the last examination ended in a 1 or 2 rating, then there could be a problem in allocations or as a result of embezzlement, things of that nature.

Now, I might say with respect to Washington Federal, Mr. Chairman, that it has been our judgment that the institution is certainly not in a problem category.

Since 1940, there have been only six failures of insured associations. In each instance, the liquidation of the association in receivership has produced or is expected to produce sufficient funds to pay in full the principal amount of all claims of savers whose deposits exceeded the maximum amount of FSLIC insurance coverage. In four of the six receiverships, a surplus has actually been achieved.

Mr. Chairman, the savings and loan business is currently financing more than 50 percent of all single-family homes in this country and approximately 40 percent of all loans in the multifamily category. This, I think, is in excess of $300 billion, probably $321 billion in mortgaged assets. And 1.2 percent of those loans are "scheduled items." That includes loans that are more than 90 days delinquent or property held as a result of loans that the institution has foreclosed.

Now, I'm not familiar with the experience of other financial institutions, but I read the newspapers. This occurs to me to be, overall, a pretty good record in terms of the practices of the business as a whole.

Now, Mr. Chairman, I'd like to skip over some of my summary and get down to some matters relating to Washington Federal. During the last 5 years, Washington Federal made or purchased approximately 7,300 mortgage loans totaling $329 million. Included were 44 loans of approximately $99 million for land acquisition or the development of multifamily structures. These are the large loans.

In addition, the association made or refinanced 86 loans that were secured by multifamily dwellings and commercial-type properties. These aggregate $57 million.

The Board's regulations place limitations on various types of real estate investments. Our examiners have not reported any instances where the investment authority was exceeded by Washington Federal. They did note that the association moved into the area of construction lending, specialty-type lending, in the early 1970's. This type of lending if too concentrated does carry additional risk factors, certainly greater risks than are incurred in the financing of single-family homes.

Now, of these 130 large loans, the development-type loans made by Washington Federal, only five were classified as substandard. This is of April 30, 1975, which is the date our last Board examination was completed. These are the slow loans or scheduled items. One nursing home was classified as substandard, not because it was not current in terms of all payments due, but because the home was not occupied or in use. There were three others in this category; there was one in 1973 and the others in 1974. The fifth, of course, was the Village Mall loan.

The subcommittee has inquired as to two loans made by Washington Federal, on the Targee Care Center and the Cambridge Care Center. Dr. Bernard Bergman is the principal of both companies. These loans were made, the first one in 1969; the second one in 1970. I might say that the loans are current and were made in conformance with the policies which the institution has to operate under. Neither of them has been in default, and they were current as of December 31, 1975.

With respect to the Village Mall loan, Washington Federal granted an 18-month construction loan on October 30, 1973, in the amount of $5 million. The interest rate was to be 2½ percent above the prime rate established by Chemical Bank. A 60-percent participation in that loan was subsequently sold to Bankers Trust Co. here in Manhattan.

The association also undertook to make individual permanent loans to the condominium purchasers up to a total of $6 million.

The principals of VMT—that is, Village Mall Townhouses, Inc.—are Lawrence Rosano and Michael Newmark. To our knowledge, the association had not done business with these individuals prior to this loan, and I'm certain they have conducted none since.

In making the Village Mall loan, Washington Federal received credit reports from Retailers Commercial Agency and Dun & Bradstreet. These were supplemented by financial statements supplied by the builders. A firm of construction consultants were employed by the association to review the plans and specifications for the project and to act as the supervisory architectural engineers. In other words, the engineers were to go out and examine the stage of construction and ascertain whether another payment to the builder could be made on the construction loan.

In the June 1974 examination report of Washington Federal, no supervisory objection was noted to the loan.

The work on the project was halted in August 1974. Many of the purchasers made downpayments, as you know, Mr. Chairman, some exceeding $7,000, on this project. I think the total was $586,000. Because of their concern for the safety of their downpayments, the New York State attorney general was asked to investigate.

I don't know what the results of that office's actions have been. I know that there have been a number of attempts to try to settle various claims that have not been successful.

Let me interject at this point, Mr. Chairman, that I know that the Federal Home Loan Bank Board would be enormously pleased if we could work out of this situation to assist the people who are going to be hurt most, which isn't Washington Federal, but the hardworking people who put up their deposits on this project. I have looked over briefly the New York State law regarding condominiums. It's looked upon generally, I think, as a sound law. New York is one of a handful of States that attempts to treat the problem of deposits of purchasers. As you know, that law, however, was basically a disclosure-type law, an SEC-type approach, as opposed to some of the bills that have been introduced, such as your own bill, Mr. Chairman, which would handle the problem by giving more protection to the people of this country who see their life savings or a portion of those savings slip away in these kinds of unfortunate situations.

To make my final observation, Mr. Chairman, we at the Federal Home Loan Bank, at the Federal Home Loan Bank Board, and I think at every level of government in the entire Nation, find ourselves, unfortunately, that most of our work is not so much precluding things that have happened, but having them happen, having people suffer, then we go and obviously respond. Hopefully that's not always true. But we do a lot of work to prevent that kind of thing. I think the Government responds, at every level. A lot of its time is taken to try and prevent the reoccurrence.

Now in this connection, Mr. Chairman, in regard to the Board's regulations, with regard to the Board's overall posture on supervision, I feel quite certain, although I have not discussed it with you, Mr. Chairman, that anytime we see situations that produce the results that are contrary to the public interest, we are going to try to be responsive to those situations.

That concludes my statement, Mr. Chairman. I would make this observation. Because my duties are concerned primarily with the operation of a Reserve bank, I obviously do not have the minute detail about the examining process or the supervisory process that Mr. Puchalsky would have or Mr. Cerreta.

Mr. ROSENTHAL. During the course of examination, you may feel free to call upon any of them for a response that they feel particularly articulate on.

I think that first we are going to deal with some generalizations, each of us take a turn, and in the second round we will deal with the specific loans in which we are acutely interested.

I do want to thank you, Mr. Curry, and I again want to affirm the absolute, 100-percent cooperation in this area of both you and your staff with the subcommittee.

Is it unusual for personnel of the Federal Home Loan Bank Board to become senior officers of savings and loan associations after these people leave the Federal Home Loan Bank Board?

Mr. CURRY. Are you speaking, sir, of the Federal home loan banks or the Federal Home Loan Bank Board?

Mr. ROSENTHAL. Let me restate it, maybe you can help me. At present, Mr. Mooney, who is the chairman of Washington Federal, was a Vice Chairman of the Board of Directors of the Federal Home Loan Bank Board, is that correct?

Mr. CURRY. Yes. He served as a director and was designated vice chairman for one of those years. My recollection is that he was elected a director of the bank and served from 1969 to 1971.

Mr. ROSENTHAL. Mr. Frank Lietgeb, who is the president of Washington Federal, was an administrative assistant to a supervisory agent of the Federal Home Loan Bank Board. Is that correct?

Mr. CURRY. Yes. I think Mr. Lietgeb was employed by the bank in the early 1950's for approximately 2 years, something of that kind. He had come there from a savings bank.

Mr. ROSENTHAL. Did you know both of these people while they were at the Federal Home Loan Bank Board?

Mr. CURRY. No, sir. Let me explain, Mr. Chairman. I came to the New York bank in 1963. Mr. Lietgeb left, I gather, several years prior to that time. Now, Mr. Mooney, was a director of the bank. He was never an employee of the bank. There is a provision in the Federal Home Loan Bank Act that permits the institution to elect——

Mr. ROSENTHAL. Did these two gentlemen serve with Mr. Puchalsky at the same time that he was in the Federal Home Loan Bank Board?

Mr. CURRY. Not Mr. Lietgeb.

Mr. ROSENTHAL. How about Mr. Mooney?

Mr. CURRY. I think Mr. Mooney—Mr. Puchalsky was on the staff of the bank during the period that Mr. Mooney served as a director.

Mr. ROSENTHAL. For the record, Mr. Puchalsky, can you just tell us about the relationship that you had with either of these two gentlemen while they were with the Federal Home Loan Bank Board? Were they superiors, equals? What was the nature of their relationship with you?

Mr. PUCHALSKY. Well, Mr. Chairman, insofar as Frank Lietgeb——

Mr. ROSENTHAL. Who are you, for the record?

Mr. PUCHALSKY. I am Harold Puchalsky, senior vice president of the Federal Home Loan Bank of New York and supervisory agent for the Board.

Frank Lietgeb was employed at the bank and left the bank before——

Mr. ROSENTHAL. What bank are you talking about?

Mr. PUCHALSKY. The Federal Home Loan Bank of New York.

Before I joined the Federal Home Loan Bank of New York. During his tenure with the bank, preceding that, I was an examiner for the Federal Home Loan Bank Board. I had very little contact with Frank Lietgeb in either capacity other than the time that I examined his association as an examiner while he was an employee at the Washington Federal.

Mr. ROSENTHAL. And how about Mr. Mooney?

Mr. PUCHALSKY. Mr. Mooney is an elected director who sits on the board of the Federal Home Loan Bank of New York. In my capacity as supervisory agent——

Mr. ROSENTHAL. Is he your superior in that capacity?

Mr. PUCHALSKY. He is a superior in the sense that he sits on the board of directors. But he has no impact whatever on the function that I perform as supervisory agent. He could not tell me what to do, how to do it, or in any sense take part in my function.

Mr. ROSENTHAL. Are there many other savings and loan associations within your jurisdiction, Mr. Curry, where the chairman of the board or officers have been formerly associated with the Federal Home Loan Bank Board?

Mr. CURRY. Yes; Mr. Chairman. Let me explain it in this sense if I could and it will only take a couple of minutes. The Federal Home Loan Bank of New York is wholly owned by its member institutions. There are really no management rights that accompany that ownership. The statute, the Federal Home Loan Bank Act, sets up a mechanism whereby the institutions who are members of the Federal Home Loan Bank can elect a portion of the board of directors.

We have five directors from the State of New York who are elected by savings and loans in the State of New York or savings banks. We have four from the State of New Jersey who are elected by the members and one in Puerto Rico. Now that makes 10 directors who are usually presidents of savings and loans associations.

In addition to that, the Federal Home Loan Bank Board appoints six directors who have no connection with the savings and loans.

Mr. ROSENTHAL. Let me restate the question, for the record. How many savings and loan associations are under your supervision?

Mr. CURRY. 328, approximately.

Mr. ROSENTHAL. And how many employees do you have under your jurisdiction?

Mr. CURRY. There are about 160.

Mr. ROSENTHAL. At a later date would you furnish for the subcommittee record the number of directors or officers of the banks under your direction who previously have been employees of the Home Loan Bank Board and vice versa?

Mr. CURRY. Do you mean the Federal Home Loan Bank Board or the Federal Home Loan Bank of New York?

Mr. ROSENTHAL. Just repeat your role with the Federal Home Loan Bank Board and the Federal Home Loan Bank of New York.

Mr. CURRY. The 12 regional banks were created by an act of Congress at the same time——

Mr. ROSENTHAL. Such as the Federal Reserve System?

Mr. CURRY. Yes. Similar to the Federal Reserve System. In 1932 there were no Federal associations and no insured associations. The Federal Home Loan Bank Act called for the establishment of the

banks and providing for a board of directors of the banks and set up a regulatory scheme for electing those directors.

However, in all honesty, as I said earlier, Mr. Chairman, under the Federal Home Loan Bank Act, a board of directors of a regional home loan bank has only the authority which the Federal Home Loan Bank Board is willing to let it exercise.

Mr. ROSENTHAL. I'm sure we could spend hours on the philosophy of the legislative-jurisdictional areas, but what I am interested in knowing, and if I am imprecise, I apologize, is, of those banks that you supervise, how many of their directors or officers are former employees of the Home Loan Bank Board or its affiliated system?

Mr. CURRY. We would be very happy to supply you with that information. Yes, sir.

Mr. ROSENTHAL. And the other way around, how many employees of the Home Loan Bank Board are formerly officers or directors of institutions you supervise.

Mr. CURRY. We would be happy to furnish that information, Mr. Chairman.

[The information referred to follows:]

WASHINGTON FS&LA NEW YORK, NEW YORK

A. FORMER EMPLOYEES OF FEDERAL HOME LOAN BANK BOARD AND FEDERAL HOME LOAN BANK OF NEW YORK WHO ARE AT PRESENT A DIRECTOR OR SENIOR OFFICER OF AN INSURED ASSOCIATION IN THE 2ND DISTRICT

Name and Occupation of Former Employee	*Name of Association and Official Capacity in Association*
Michael Zarrilli: July 1938 to March 1954—FHLBB Examiner. March 1954 to March 1966—Exec. Vice Pres., FHLB of New York.	West Side FS&LA of New York City, New York, New York, Chairman of Board, President and Managing Officer, March 1966 to present.
Herman Garlock: March 1941 to January 1966—FHLBB Examiner.	West Side FS&LA of New York City, New York, New York, Vice President and Secretary, January 1966 to present.
Manuel L. Fenner: June 1956 to April 1975—FHLBB Examiner (Retired).	West Side FS&LA of New York City, New York, New York, Vice President, April 1975 to present.
John V. Davis: June 1955 to February 1956—FHLBB Examiner.	Franklin Society FS&LA, New York, New York, Vice President, August 1967 to present.
Frank H. Gillespie: November 1948 to April 1954—FHLBB Examiner. May 1954 to June 1961—Asst. Treas., FHLB of New York.	Walt Whitman FS&LA, Huntington Station, New York, President, Director and Managing Officer, November 1963 to present.
Paul P. Gilles: February 1937 to April 1948—FHLBB Examiner.	Charter S&LA, Randolph Township, New Jersey, President, Director and Managing Officer, August 1965 to present.
John S. Kettle: June 1972 to March 1975—FHLBB Examiner.	Dime Banking and Loan Association, Rochester, New York, Treasurer, March 1975 to present.
Edwin L. Haimbach: January 1949 to January 1954—FHLBB Examiner.	First FS&LA of Montclair, Montclair, New Jersey, President, Director and Managing Officer, January 1954 to present.
James R. Hally: March 1946 to December 1947—FHLBB Examiner.	Empire State FS&LA, White Plains, New York, Vice President and Secretary, December 1947 to present.

Name and Occupation of Former Employee	*Name of Association and Official Capacity in Association*
Henry Lapp: December 1956 to January 1962—FHLBB Examiner.	Spring Valley S&LA, Spring Valley, New York, President, 1962 to present.
Harold K. Mathis: June 1948 to September 1950—FHLBB Examiner.	Lincoln FS&LA, Westfield, New Jersey, Executive Vice President, Secretary and Director, September 1950 to present.
Robert J. Olsen: May 1956 to March 1965—FHLBB Examiner.	Keystone S&LA, Neptune, New Jersey, President, Director and Managing Officer, March 1965 to present.
John T. O'Toole: July 1960 to May 1970—FHLBB Examiner.	Homestead S&LA of Utica, Utica, New York, President, Director and Managing Officer, May 1970 to present.
Walter C. Provost: August 1939 to December 1955—FHLBB Examiner.	Robert Treat S&LA, Newark, New Jersey, President, Director and Managing Officer, January 1956 to present.
Sydney Smiley: September 1949 to March 1974—FHLBB Examiner (Retired).	County FS&LA, Rockville Centre, New York, Vice President, October 1975 to present.
Anthony Surano, November 1940 to January 1950—FHLBB Examiner.	Carteret S&LA, Newark, New Jersey, Director and Consultant (Retired President and Managing Officer), January 1950 to present.
Peter Traikos: June 1958 to November 1972—FHLBB Examiner.	Guardian FS&LA, Northport, New York, Vice President, July 1973 to present.
Everett C. Sherbourne: August 1936 to December 1939—FHLBB Examiner.	City FS&LA, Elizabeth, New Jersey, Chairman of Board and Consultant, (Former President and Managing Officer) January 1940 to present.
Richard A. Pettit: July 1956 to December 1963—FHLBB of New York, Secretary.	City FS&LA, Elizabeth, New Jersey, Vice President, January 1964 to present.
Donald A. Murphy: May 1952 to December 1955—FHLB of New York, Clerk, Accounting Dept.	City FS&LA, Elizabeth, New Jersey, Vice President, December 1955 to present.
Herbert J. Kupfer, November 1961 to November 1965—FHLB of New York, Analyst, Supervision.	City FS&LA, Elizabeth, New Jersey, Vice President, November 1965 to present.
Frank A. Lietgeb: January 1955 to February 1958—FHLB of New York, Administrative Asst., Supervision.	Washington FS&LA, New York, New York, President and Director, March 1958 to present.
George Turturro: February 1965 to August 1969—FHLB of New York, Analyst, Supervision.	Kearny FS&LA, Kearny, New Jersey, Secretary and Treasurer, September 1969 to present.
Lawrence V. McCabe, November 1936 to 1948—FHLB of New York, Clerk, Acct. Dept.	Northern Valley-Englewood S&LA, Englewood, New Jersey, President, Director and Managing Officer, 1948 to present.
John Wessling: September 1949 to March 1952 of New York—Research.	Haven S&LA, Hoboken, New Jersey, President, Director and Managing Officer, April 1952 to present.

B. CURRENT EMPLOYEES OF THE FEDERAL HOME LOAN BANK BOARD OR ITS AFFILIATED SYSTEM IN THE NEW YORK DISTRICT (2ND DISTRICT) THAT WERE FORMERLY A DIRECTOR OR SENIOR OFFICER OF AN INSURED ASSOCIATION IN THE 2ND DISTRICT

NONE

Mr. ROSENTHAL. Now, are you interested in the constituency and makeup of the board of directors of the savings and loans that you supervise?

Mr. CURRY. Of course.

Mr. ROSENTHAL. Do you have regulations covering these areas?

Mr. CURRY. Yes.

Mr. ROSENTHAL. Does it interest you at all when directors of these

institutions are given mortgages at preferential rates by these institutions?

Mr. CURRY. Let me say it this way, Mr. Chairman. The Federal Home Loan Bank Board has determined that an officer or a director would be able to obtain a loan, a home mortgage loan only, at a rate not less than the average cost of funds to that institution. I presume the theory is, Mr. Chairman, that if you work for a business, this slightly lesser interest rate is a fringe benefit of that employment.

Mr. ROSENTHAL. Mr. Drinan?

Mr. DRINAN. Only the directors get this? Not the regular employees?

Mr. CURRY. Every employee.

Mr. DRINAN. Including the directors?

Mr. CURRY. Any employee, any director, it must be a home loan.

Mr. DRINAN. So there is no preferential treatment of directors as directors?

Mr. CURRY. No.

Mr. DRINAN. Thank you.

Mr. ROSENTHAL. Now, in Washington Federal's case, I refer to the 1975 examination report, is Mr. George A. Mooney the chairman?

Mr. CURRY. Yes.

Mr. ROSENTHAL. Is his current annual salary $100,000 and additional remuneration from the association $4,750?

Mr. CURRY. That sounds correct.

Mr. ROSENTHAL. I am reading from your report. Mr. Mooney is the chairman of the board and Mr. Lietgeb is the president with an annual salary of $75,000 with additional remuneration of $3,000, which in both those cases are bonuses, representing 5 percent of salary received in 1975. That is from your report.

Now, in 1975, the association made mortgage loans to three directors: Vincent and Ann Kennedy's in Staten Island is $35,000 at an interest rate of 8 percent; Elie and Caribe Abel's of Armonk, N.Y., is $60,000 at a rate of 8 percent; and Dimetrio and Divola Mavrogenis' of New Milford, N.J., is more than $28,500 at a rate of 8½ percent. Now, were those going rates at the time?

Mr. CURRY. I would say that in the State of New York, the going rate has been 8½ percent since the usury limitation was raised to that level. I don't recall the date on which that was increased to 8½ percent. Of those three people, I know that Mr. Abel is a director of the association. I believe the other two are down-the-line employees of the institution.

Mr. ROSENTHAL. Now, are directors of the association supposed to be broad-based, community-oriented, or bring something special in either experience or knowledge to the directorship?

Mr. CURRY. Yes, we would certainly hope that that would be an objective.

Mr. ROSENTHAL. Do you ever examine directors' background and make recommendations to your members?

Mr. CURRY. Yes, we do.

Mr. ROSENTHAL. In the case of Washington Federal, could you give me your view of the spectrum of the professional experiences of the directors of the association?

Mr. CURRY. Let me say this. I don't personally know any director of that institution other than Mr. Mooney. When I look over the list of the various activities or the various businesses or the kind of

activity which those gentlemen have been engaged in, it strikes me as a rather broad-based type of board of directors.

Mr. ROSENTHAL. Now, the regulations of the board, and if I am incorrect, correct me, suggest that when you charter a savings and loan association, a majority of directors must have both professional and residential interest in the community.

Mr. CURRY. One or the other, yes.

Mr. ROSENTHAL. Does that requirement continue after the savings and loan association is in existence for a period of time?

Mr. CURRY. Sometimes it doesn't. I can't recall a specific example now.

Mr. ROSENTHAL. Would you look at page 16 of your report and tell me how these directors conform to those regulations of the board?

Mr. CURRY. I want to clarify. I think we have some information on the directors. I'm sorry, Mr. Chairman, your question was——

Mr. ROSENTHAL. Could you tell us by looking at both the profession and residences of Washington Federal's board if you know them, how Washington Federal's board of directors conforms to the regulations of the board? Do they fit your requirements for either professional or residential interest in the community in which the institution is located?

Mr. CURRY. I can't answer that 100 percent, Mr. Chairman, because I'm not sure now where they live. I do know that Washington Federal has developed a branch system that operates——

Mr. ROSENTHAL. Could you furnish for the record, then, a list of all directors, their home addresses, and whether they live or reside or practice professionally in the area served by either the home office or any of the branches of Washington Federal?

Mr. CURRY. We would be very happy to supply that.

[The information referred to follows:]

WASHINGTON, FS & LA, NEW YORK, N.Y.

Name of director	Home (H) and business (B) addresses	Area served by either the home or branch office
George A. Mooney, chairman of the board and chief executive officer.	187 Puritan Ave., Forest Hills, N.Y. (H). 1390 St. Nicholas Ave., New York, N.Y. (B).	1390 St. Nicholas Ave., New York N.Y.
Frank Lietgeb, president and director.	1500 Palisade Ave., 16-F, Fort Lee, N.J., (H). 1390 St. Nicholas Ave., New York, N.Y. (B).	Do.
Elie Abel, director	13 Banksville Rd., Armonk, N.Y. (H). Dean, Graduate School of Journalism (B), Columbia University, 116th and Broadway, New York, N.Y.	Hamilton Plaza, Hamilton Ave. and Church St., White Plains, N.Y. (approved but unopened).
John J. Brennan, director	15 Kensett Rd., Manhasset, N.Y. (H). President, Julius Nasso Concrete Corp., 142 East 39th St., New York, N.Y. (B).	
Edward J. Devlin, Jr., director	650 Park Ave., 11-B, New York, N.Y. (H). Retired real estate consultant.	
Wallace J. Gardner, director	1329 Cambridge Dr., Venice Gardens, Venice, Fla. (H). Retired stock broker.	
Menard M. Gertler, M.D., director	1000 Park Ave., New York, N.Y. (H). Director, Cardiovascular Research Institute of Rehabilitative Medicine, New York University Medical Center, 400 East 34th St., New York, N.Y. (B).	
Joseph F. Periconi, director	1733 Astor Ave., Bronx, N.Y. (H). Attorney, 100 Stephens Ave., Mount Vernon, N.Y. (B).	2150 White Plains Rd., Bronx, N.Y.
Gustave G. Rosenberg, director	630 Park Ave., New York, N.Y. (H). Retired lawyer.	
John J. Sheehan, director[1]	4312 50th Ave. South, St. Petersburg, Fla. (H). Retired treasurer of the New York Times.	
Michael A. Wilton, director	12 Bellwood Rd., White Plains, N.Y. (H). Insurance consultant and president, David A. Carr Agency, 6 East 43d St., New York, N.Y. (B).	Hamilton Plaza, Hamilton Ave. and Church St., White Plains, N.Y. (approved but unopened).

[1] Retired as a director, effective Feb. 1, 1976.

WASHINGTON FS&LA, NEW YORK, N.Y.

Home Office—1390 St. Nicholas Avenue, New York, New York 10033.
Branch Offices—275 West 231st St., Bronx, N.Y. 10463; 371 East 149th St., Bronx, N.Y. 10455; 2150 White Plains Road, Bronx, N.Y. 10462; George Washington Bridge Bus Station, Fort Washington Avenue, New York, N.Y. 10033; 1068 Morris Park Avenue, Bronx, N.Y. 10461; 725 Co-op. City Boulevard, Bronx, N.Y. 10475; Monsey Valley Shopping Center, 9 Route 59, Monsey, N.Y. 10952; 1725 Central Park Avenue, Yonkers, N.Y. 10710; 601 Fort Washington Avenue, New York, N.Y. 10040;[1] Hamilton Plaza, Hamilton Avenue and Church St., White Plains, N.Y. 10601.

Mr. ROSENTHAL. I would also ask you to comment, for the record, on the nature and extent of the occupation of these people and how they fit into the general performing pattern of a contribution by a cross section of society. In other words, my quick look at the directorships shows only two people who had any previous banking experience, which is Mr. Mooney and Mr. Lietgeb, and one man who had real estate experience, and all the rest are a kind of broad-based group of citizens.

Mr. CURRY. Yes. Well, I might say, Mr. Chairman, that we frown on——

Mr. ROSENTHAL. None of whom live in the market area served by the association.

Mr. CURRY. Well, I frankly do not know where they live, although I'm sure our records at the bank disclose where they live. I think Mr. Goldberg has a comment, if you will permit, Mr. Chairman.

Mr. GOLDBERG. Mr. Chairman, we gave you our current chartering guidelines. I think it is important to note that over the years they change from time to time so that the guidelines that this institution would have been subject to in their charter may be drastically different than what we provided to the subcommittee in our statement.

Mr. ROSENTHAL. Well, then, you will provide for the record all of your regulations which have been in effect since 1941 regarding the residency and other requirements for the board of directors of federally chartered associations and the dates that each such regulation has been effective.

[The information referred to follows:]

In addition to a citizenship requirement, the current requirements concerning qualification of directors of newly chartered Federal savings and loan associations are as prescribed for directors of newly chartered associations applying for insurance of their accounts. Regulatory proposals now pending would provide new guidelines with respect to such directors.

The current (since 1/31/69) requirements, which are contained in instructions for preparing applications, are as follows:

(a) a representative, well balanced board of at least seven directors, containing at least a majority who have both their residences and their business or professional interests in the community to be served with the remainder having one or the other; not more than one-third who are in businesses closely related to the savings and loan business; not more than two salaried officers or employees of the institution or the institution's attorneys; not more than two members of the same family; not more than one member of the same law firm; less than one-third who are serving as directors or officers of banking institutions and not more than two who are serving as directors or officers of any other institution of the savings and loan type including a mutual savings bank;

(b) none of the officers of the institution shall, during his term of office, serve as a director or officer of any other institution of the savings and loan type including a mutual savings bank or as an officer of any commercial bank;

[1] Approved but unopened.

Previously, in 1960, the following were the criteria:

Directors. As proof of the representative nature of the directorate and of the interests of its members in the locality to be served, the following requirements should be met:

(a) *Number.* The directorate shall consist of at least seven members.

(b) *Local Interest.* At least 75% of the directors should have residence or business interests in the general locality of the office of the applicant. Justification should be given if any directors are not from the area.

In 1958, our files indicate the following was the standard:

Association has established a board of directors composed of citizens representative of the diversified interests of the community (or, in the alternative, "general area" if more appropriate) in which the association is located, with at least two-thirds not engaged in any business closely related to the savings and loan business.

In 1954, the standard condition provided for establishment of a board of directors "*reasonably well balanced*" and composed of citizens representatives of the diversified "*commercial and professional*" interests etc. (as per the 1958 requirement).

We have been unable to locate any formalized requirements for the period prior to 1954.

Mr. ROSENTHAL. Mr. Abel, who is a dean of the Graduate School of Journalism at Columbia, was appointed in 1974, so he would be subject to the new guidelines. Mr. Gardner was appointed in 1974.

Mr. GOLDBERG. Mr. Chairman, we will provide the material you requested but it isn't when the director is appointed, it is the guidelines that were in existence when the charter was granted. That is what controls the institution. If this charter was granted years ago, as I believe it was, we would only look to those guidelines for control.

Mr. ROSENTHAL. Well, that is a very important point. Do new regulations adopted by the Board, amend the original guidelines that existed at the time the association was chartered?

Mr. GOLDBERG. In this area of charter, you are guided by the charter requirements in effect at the time of its issuance. Other regulations enacted subsequently are applied prospectively to such institutions.

Mr. ROSENTHAL. In other words, the people who were originally appointed are not only grandfathered in, but anybody else who meets the criteria at that time would be grandfathered in?

Mr. GOLDBERG. Yes; except in the regulations being considered by the Board at the present time which would have the effect of imposing continuing requirements respecting the boards of directors. I cannot say whether that will or will not be adopted but it is being considered. And I think you are correct, Mr. Chairman, that in this limited area, at the present time you are guided by the chartering requirements when the institution was chartered except that we will not permit any relationships that we consider unsafe or unsound.

Mr. ROSENTHAL. Mr. Curry, do you think that when you give a mortgage of significant amount—let's take Elie Abel as an example because that is a name that strikes public consciousness—such as a mortgage of $60,000, do you think that in any way affects his decisions at Board meetings?

Mr. CURRY. I wouldn't think so, Mr. Chairman, because the regulations of the Board permit him to obtain a home mortgage loan. He could not finance some business activity.

Mr. ROSENTHAL. Well, he knows that.

Mr. CURRY. I would certainly hope not, Mr. Chairman.

Mr. ROSENTHAL. You don't think it does. If he got a preferential rate? Do you know whether he paid the ordinary closing costs and all other costs that accompany it?

Mr. CURRY. I would not know that, no, sir.

Mr. ROSENTHAL. Do you think there is something inherently wrong in that? It would be healthier in the public interest if the directors couldn't be given opportunities to get home mortgages in the event that they have to make major decisions as directors?

Mr. CURRY. Let me answer this way, if I could, Mr. Chairman. I think in terms of the employees of the association, youngsters who are just starting out, at relatively low salaries. If you give them a home loan and you charge them a rate less than market rate, it has the effect of increasing their salaries by that much. I see nothing wrong with that practice.

Mr. ROSENTHAL. Do you think telephone company employees should get discounts on their phone bills—young families starting out—to cut down their phone bills?

Mr. CURRY. Mr. Chairman, I would have to think about that one. I don't know anything about the telephone company. I do know that corporations throughout the country, as a part of their program of trying to obtain employees, particularly during periods when the labor markets are tight, do give discounts, for example. If you work for——

Mr. ROSENTHAL. Do other home loan banks around the country approve of this practice the same way you apparently do?

Mr. CURRY. This is a rule, Mr. Chairman. I want to make a distinction, if I could. I address myself first of all to the employees of the association. Now you have asked about Mr. Elie Abel, who is a director. I guess I would have to say to you, Mr. Chairman, that I do not believe that a great number of men who have reached a directorship on a large financial institution should need the additional enticement of giving them a loan at less than market rate.

And I don't know whether this loan is less than market or not. I'd have to go back and check as to the point in time when that loan was made. Because, as you know, here in New York they started out not too many years ago with a 6 percent interest rate and we have continued to raise that.

I really don't want to be evasive, Mr. Chairman, but, on the employees "yes", on the directors, I would certainly think that this is something that ought to be considered very carefully.

This is not limited to this district. This applies throughout the entire country.

Mr. ROSENTHAL. That's part of the problem. Last year's examination report of Washington Federal indicated that as of April 15, 1975, Washington Federal's ratio of scheduled items to net assets increased from 0.9 percent to 1.6 percent, while the ratio of net worth increased from 23.4 percent to 42.7 percent and that these ratios were 4 times the district average for similar institutions. What is the significance of such a high ratio of scheduled items to net assets or net worth?

Mr. CURRY. Let me ask Mr. Puchalsky, if I may, to comment.

Mr. PUCHALSKY. Determination of an investment as to whether it is a scheduled item is based on a formula that we have in the regulations.

Mr. ROSENTHAL. Would scheduled items include a slow loan, a slow payment or bad loan?

Mr. PUCHALSKY. Right. It doesn't necessarily mean that the association will lose its investment on that scheduled item. It just means that loan payment performance is poor and as a result of that it is classified as a scheduled item. While the association's scheduled item position exceeded its peer class in our district, it by no means exceeded the national averages. We place a great deal of concern on an association's quality of assets. In this particular case we did indicate that in our supervisory practice. We alerted the board to the seriousness of the situation——

Mr. ROSENTHAL. What board?

Mr. PUCHALSKY. The board of directors of the association.

Mr. ROSENTHAL. Well, they had just gotten home loan mortgages, so they knew how bad things were. Right?

Mr. PUCHALSKY. Well, right. They got three loans from the association on their owner occupied residences. To retain this rate they have to stay with the association. If they convey the secured property, the loan would be called.

Mr. ROSENTHAL. Is Washington Federal's current net worth below the Federal Home Loan Bank Board's requirements?

Mr. PUCHALSKY. Yes; it is, sir.

Mr. ROSENTHAL. By how much?

Mr. CURRY. Mr. Chairman, could I speak briefly to this issue? I do have a concern and perhaps the Federal Home Loan Bank Board has a concern that a detailed discussion of this institution could produce consequences which are wholly unwarranted. The institution has a net worth position, I think, of around $17 million. We do not classify the institution as having any problems which would impact the public in any fashion whatever or indeed the Federal Savings and Loan Insurance Corporation.

However, I certainly want to go as far as you, Mr. Chairman, having experiences in New York and knowing that this institution operates in areas of certain groups, basically blue collar depositors, I would certainly hate to see an institution which I think is reasonably sound have this happen.

Mr. ROSENTHAL. Have what happen to it?

Mr. CURRY. A run on the institution, sir.

Mr. ROSENTHAL. As a result of what?

Mr. CURRY. A discussion of their problems.

Mr. ROSENTHAL. We are now getting into a fundamental question. You don't think we should discuss their problems in public?

Mr. CURRY. What I am saying, sir, is that, and I have not and will not refuse to answer questions you ask here, but I do want you to share with me or at least understand that I do have some concern. That's all.

Mr. ROSENTHAL. This Member of Congress appreciates your concern. In my judgment, part of the problem is that all these years most of you people have been operating with secret intrafraternity relationships. I don't see anything wrong with discussing things in public. We have no way of knowing whether you are doing a good regulating job until we discuss these things.

The public has no way of assessing your responsibility or ours if we don't talk about it. If we are all going to meet in camera and exchange mortgage loan information we might as well give up the whole system.

I'm sure you don't mean to do that. We are sensitive to our public responsibilities.

When did Washington Federal's net worth first fail to meet the Board's minimum level requirements?

Mr. CURRY. March of 1975, I believe.

Mr. ROSENTHAL. Prior to March 1975, was there any indication that Washington Federal would have difficulty meeting its net worth requirements?

Mr. CURRY. I believe there was, Mr. Chairman.

Mr. ROSENTHAL. As of the last report submitted on or by Washington Federal, how far below the minimum net worth requirements was Washington Federal?

Mr. CURRY. On their last semiannual report which was the June 30 report, it was $248,000.

Mr. ROSENTHAL. When is the next report due?

Mr. CURRY. It is due before January 30.

Mr. ROSENTHAL. Do you think this next report will show a deteriorating net worth position?

Mr. CURRY. I think there will be some deterioration in the net worth position.

Mr. ROSENTHAL. Do you think directors should continue to get $300 a meeting while this is going on?

Mr. CURRY. Well, if I could answer it this way, Mr. Chairman, we, from a supervisory standpoint, look at the overall ratios of the institution. If those expense ratios are out of line, we have, from time to time, taken certain steps to try to bring it down. I have been very reluctant, Mr. Chairman, to try to dictate except in situations of, let's say, a problem situation——

Mr. ROSENTHAL. Let me give it to you straight. What was their net loss as of the year ended December 31, 1974? Do you know?

Mr. CURRY. I can find out very quickly. Mr. Chairman, could I take 1 minute to give you the background to the situation, the Washington Federal situation?

In 1963, prior to the time that I came to New York although I had a knowledge of what went on in the institution, the president of the association and about four or five of its officers were indicted. The president immediately hung himself in the institution. The other officers——

Mr. ROSENTHAL. I know there is a sad, sordid story. While you were chairman for the New York region, for the year ending December 31, 1974, how much was their net loss? Was it $602,920?

Mr. PUCHALSKY. The bottom line figure? If you have the report in front of you, the examination report, if you look up three or four lines and the caption "Net Operating Income," that is normal operating income. The association had profitable operations during that period. However, as a result of sale of assets and deep discounts which are nonoperating types of losses, it reduced their operating net. They were operating profitably during that period. However, as a result of those chargeoffs, your figure is correct.

Mr. ROSENTHAL. Thank you. Was their net loss $326,140 as of the 3-month period ended March 31, 1975? Do you think directors should continue to pay themselves $300 per meeting under those circumstances?

Mr. PUCHALSKY. Are you asking me, Mr. Chairman?

Mr. ROSENTHAL. I am asking anybody.

Mr. CURRY. Mr. Chairman, the association is now under examination. Whenever that examination is concluded, we obviously will look it over very carefully in relation to expense ratios and will take whatever kind of action in the area of expense ratios that the situation seems to dictate.

Mr. ROSENTHAL. Are the total reserves below your requirements?

Mr. CURRY. They are below the statutory requirements.

Mr. ROSENTHAL. When did they first fail to meet the minimum level requirements?

Mr. PUCHALSKY. March 31, 1975.

Mr. ROSENTHAL. Did you ever tell the president that he should cut his salary from $100,000 a year?

Mr. PUCHALSKY. No, sir.

Mr. ROSENTHAL. Did you ever tell the chairman of the board who was getting about $105,000, that he didn't have to do anything.

Mr. CURRY. He was the chief executive officer, Mr. Chairman.

Mr. ROSENTHAL. Have you received a pay raise in the last years? Aren't you people locked in with us?

I'm now going to turn this over to Father Drinan for more vigorous questioning.

Do you make more than we do?

Mr. CURRY. I haven't kept very close, Mr. Chairman, with what Members of Congress make, but I know that it is too little.

Mr. ROSENTHAL. Well, everybody else in this country does.

Mr. GOLDBERG. The Board which consists of the vast majority of employees of the Federal Home Loan Bank system are in Federal service and, of course, are below the salary rate for Congress.

Mr. ROSENTHAL. As of the last report submitted on or by Washington Federal, how far below the minimum reserve requirement was Washington Federal?

Let me answer because it seems to go faster that way.

As of March 31, 1975, they were $871,366 short and as of May 31, 1975, they were $1,201,681 short. Is that correct?

Mr. PUCHALSKY. That is correct, sir.

Mr. ROSENTHAL. What was their net loss as of those 3 months ended March 31, 1975?

Mr. PUCHALSKY. You are asking me to subtract?

Mr. ROSENTHAL. I'll give you 30 seconds, otherwise I'll answer it.

Mr. PUCHALSKY. Close to $400,000.

Mr. ROSENTHAL. Close to $400,000. When are you going to get with these people?

Mr. CURRY. Mr. Chairman, we have been with these people, if you will. We have been having discussions since early last fall, which have not yet reached a satisfactory solution.

Mr. ROSENTHAL. Let me just ask you, the other members of the subcommittee are chomping at the bit to get started and I hate to monop-

olize the time, but do you believe that an association with Washington Federal's track record should invest in high-risk construction loans?

Mr. CURRY. I don't think that any institution should invest in any loan where the risk goes beyond some certain undefinable point. I don't know what that point is, Mr. Chairman.

Mr. ROSENTHAL. Did you ever sign a supervisory agreement with Washington Federal?

Mr. CURRY. No, sir.

Mr. ROSENTHAL. Are you contemplating such an agreement?

Mr. CURRY. Well, as I indicated to you, Mr. Chairman, we have had discussions. Those discussions have not resulted in any agreement to this date. The institution is now under examination. That examination will be concluded within 1 month and we felt that it was essential to wait and to look at the new figures, and then to go where the facts dictate as they relate to our regulations.

Mr. ROSENTHAL. Did Washington Federal make an application to you seeking a forbearance from section 563.13 of the Board's insurance regulations?

Mr. CURRY. I believe they did, sir.

Mr. ROSENTHAL. What does that mean?

Mr. CURRY. Maybe Mr. Puchalsky—this is a very complicated regulation.

Mr. PUCHALSKY. The way I understood their petition for forbearance is that at the time Mr. Mooney took his position with the association, he was under the impression that there was an understanding that as a result of the prior administration's lending practices, the association would be reimbursed for those losses.

Mr. ROSENTHAL. Who would reimburse them?

Mr. PUCHALSKY. The insurance corporation.

Mr. ROSENTHAL. By your insurance corporation?

Mr. PUCHALSKY. That was his understanding.

Mr. ROSENTHAL. Did he say, "I'll cut my salary if you do that?"

Mr. PUCHALSKY. I can state categorically that at this stage the forbearance has not been approved.

Mr. ROSENTHAL. Is it pending?

Mr. PUCHALSKY. It is not pending actively as far as I understand. The insurance corporation is under rigid statutory limitations.

Mr. ROSENTHAL. Let me ask you the ultimate question, do they have any applications pending for new branch offices?

Mr. CURRY. No; not to my knowledge. One could have come in in the last week or so. I might not have been advised about it.

Mr. ROSENTHAL. What about the branch office at Hamilton Avenue and Church Place?

Mr. CURRY. That application came in last year, Mr. Chairman, and was approved.

Mr. ROSENTHAL. Did your office approve it?

Mr. CURRY. We sent the application to Washington with an analysis of the application which, if you do not have, I will be very happy to supply.

Mr. ROSENTHAL. Did you approve a "new office" application for a bank in this condition?

Mr. CURRY. Mr. Chairman, this association, at that time had a rating of 2–C. At that time there had been no failure of net worth.

Please keep in mind, or at least I keep in mind, if we have institutions who are so stuck, if you will, in a part of the city and their people are leaving them, as a matter of our supervisory concern to strengthen the institution; we look at that very carefully at whether management has other branches operating, has demonstrated a capability to run those branches and make them a profitable operation.

Mr. ROSENTHAL. At the time you approved this application, Washington Federal failed to meet your own net worth and reserve requirements and was losing money; were you risking the public's funds and increasing their insurance protection?

Mr. CURRY. Mr. Chairman, I don't believe that those were the facts. I have them here and I'll be glad to give them to you or to read them to you or to pick out parts, whatever you want?

Mr. ROSENTHAL. I will now pass this first phase inquiry to the other members, and I will return to this line of questions and the specifics of the Village Mall loan.

Congressman Drinan?

Mr. DRINAN. Mr. Chairman, you are doing very well, and I don't mind your continuing. Let's stay on this White Plains thing for a moment. I take it the loan was granted.

Mr. CURRY. It was approved.

Mr. DRINAN. Let's follow through on that. Is it operational? Is it an asset to the bank?

Mr. CURRY. That branch is not yet open. It was our conclusion that it would be helpful to the citizens of the area where they proposed to locate. It was our conclusion that the market area and the association's success with other branches——

Mr. DRINAN. How much has the association spent on the White Plains venture?

Mr. CURRY. I do not know.

Mr. DRINAN. Isn't that essential?

Mr. CURRY. Yes, it is.

Mr. DRINAN. Why don't you know? You had to make some assessment before you approved the White Plains operation and there was opposition to it from the Empire State Federal Savings and Loan there. In any event, it was approved, and what was the date of that approval again—a year ago? In any event, it seems to me that's a pretty essential question.

Mr. CURRY. Yes. There is a required budget that has to be filed. A net budget would include the amount for rent or remodeling or whatever. It's just that I don't have those facts in front of me, at the moment.

Mr. DRINAN. Have you considered rescinding the permission to open a branch or do you feel that this is an asset that will certainly help the bank to become solvent?

Mr. CURRY. I think it will help.

Mr. DRINAN. Do you have any facts, we are just trying to get to the facts and all of a sudden we have a very tough situation where contrary to all the other banks you regulate this one has very severe difficulty and——

Mr. CURRY. If I could, sir; I must disagree with you, sir, that it has severe financial difficulty. I could not categorize it in that fashion at all.

Mr. DRINAN. OK. Just tell us why you people thought that going into White Plains was a good venture for this bank at this time.

Mr. CURRY. We thought, as I indicated to you, that the people in that area needed this kind of service and we thought that it would be profitable to the institution.

Mr. DRINAN. Did you have a market survey done?

Mr. CURRY. The institution either does one or they supply us with figures or a survey and we, in turn, have people that go out and look over the market area.

Mr. DRINAN. You have documentation to justify all this?

Mr. CURRY. Yes, sir, of course.

Mr. DRINAN. I think it's pretty essential that, if we want to make some estimate of how you people are carrying on your statutory duties, we have some indication that you people have considered that this association should move into White Plains and that the assets they would obtain or the profits that they would make would in fact help, shall we say, to stabilize this bank. I don't see anything in the record and I don't hear anything that justifies that particular decision on your part.

Mr. GOLDBERG. We will be happy to submit for the record the documentation. In a case such as this, before the application can be approved, we require comprehensive submissions from the applicant, including detailed economic analysis. If there's written protest, an oral argument is required and we would have in our files the bases for approving it as far as the regulatory criteria plus the reasons why the agency was——

Mr. DRINAN. Must we assume, you are assuming that there is sound management at the head of Washington Federal, and you presumably felt that people there without any change could go and open a new branch and presumably do a good deal better than they had been doing in their other banks.

Mr. CURRY. Congressman Drinan, as I started to say earlier, the losses which have occurred in this institution were losses on properties that were placed on the books of the association prior to the Mooney management. The decrease in net worth or decrease in the required Federal insurance reserve resulted because they had to charge those losses against that account. These were loans, unfortunately they were speculator-operator type loans made in the South Bronx——

Mr. DRINAN. The board of directors hasn't changed substantially. We can't say there is a pre-Mooney and a post-Mooney. The board of directors was substantially the same. How many have changed?

Mr. PUCHALSKY. I would say, sir, of the original board, prior to Mr. Mooney's entering the association, that there is not one active director still on the board.

Mr. DRINAN. I take it therefore that you people have total trust in the Mooney board and what they have done since he came in?

Mr. PUCHALSKY. We have confidence in that board at this time.

Mr. GOLDBERG. Other than for the past administration's bad investments, this institution would have a profit of approaching $1 million. There was a writeoff of previous fiscal period losses. And this was not a loss in operating income but a loss generated by the fact there was a sale and writeoff of previous investments.

Mr. DRINAN. In the last 2½ years, Washington Federal has opened other branches with your approval, one in Yonkers, another one on

Fort Washington Avenue, and one in Monsey, N.Y. Have they worked out? Are they successful?

Mr. CURRY. I would say so, yes.

Mr. DRINAN. And you feel that the best way to writeoff the losses or to recoup the losses is to move into new areas, new neighborhoods, and so forth. Is that demonstrated, that the Mooney management can in fact recoup the losses by this method?

Mr. CURRY. I think that is one part of it. Because these are mutual institutions and the only way that they can accumulate reserve accounts is through retained earnings. In other words, there's no equity being invested. So to come back, their earnings must be sufficient to cover operating expenses, pay interest on depositors and have enough left over to bring this reserve level back up to an acceptable or a statutory minimum. The statute calls for 5 percent.

Mr. DRINAN. Is there any other way of doing it? How about retrenchment?

Mr. CURRY. I think in terms of cutting of their expense ratio as much as possible. Basically, to run a heads-up, sharp institution.

Mr. DRINAN. Well, I am waiting, sir, for some indication that you people went over this institution with a fine comb and that you came to the conclusion that White Plains is a good venture because these other ventures have worked out and I am not hearing anything.

You approved of Yonkers on September 28, 1975. You approved Washington Avenue in September 1974, and you approved Monsey, N.Y., in September 1973. Now, is there any indication that this is the way for this bank to go? Are these branches operational?

Mr. CURRY. I will be very happy to furnish a——

Mr. DRINAN. That doesn't help me. If you don't have it, you don't have it. I'm asking this, taking a pinpointed example here, and you say that the problems are in the past now. Yet you concede that the situation is still deteriorating. And this doesn't add up to me. You say that the pre-Mooney management did all of the unfortunate things and yet you have said that the forthcoming examination is not necessarily going to be favorable. And that the below the minimum reserves will continue and there is not going to be a profit. There is going to be a loss.

Mr. CURRY. If we could distinguish, sir, between profits and the charge to the reserves, it is my judgment——

Mr. BROWN. If the gentleman would yield for a moment?

I think it might be well for you to distinguish between current profit and loss versus cumulative or paper profit and loss. And I think you ought to discuss, possibly, when an institution has to write off a loan, when it has to write down a loan so as to kind of educate the committee on the banking practices that go on. Because this, I think, is what you are saying.

Mr. DRINAN. I think that is a good question. I will yield. I think my time has expired and I yield to this very good question from the gentleman from Michigan.

Mr. CURRY. I will try to explain it as best I can.

Mr. BROWN. I have the advantage, if I may interrupt, of serving on the Banking, Currency and Housing Committee as well as this committee, so I think that possibly your terminology is a little more familiar to me than to some of the other members of the committee. Before you answer, I would also like to say that I share the concern

that Mr. Curry has expressed of regarding the information, testimony, or evidence which is elicited at this hearing being heard by the unsophisticated who are not familiar with the regulation standards promulgated by the Board; and the unsophisticated getting a visceral reaction to it that is unjustified from the standpoint of the safety of the depositor, even the equity position.

And that is the concern that I have. And that is pretty much the concern that Mr. Curry was expressing. But it would be good, I believe, Mr. Puchalsky, to explain what you mean when you are talking about a present profit loss net worth position being affected by prior loans and the write-offs, write-downs, et cetera.

Mr. PUCHALSKY. The misconception, if there is one, perhaps results from the way we present our statement of operations in our reports. If an association charges losses to its reserves or surplus account or undivided profits, we require that they reflect these losses through the operations string.

Now these losses generally are for investments made in prior years and as a result of that we show it as a nonoperating item. It is not normal operations expense or——

Mr. ROSENTHAL. Were these investments carried on the books at full value as an asset?

Mr. PUCHALSKY. I will explain that too, sir. According to our regulations——

Mr. ROSENTHAL. I think you are complicating a simple concept.

Mr. PUCHALSKY. According to our regulations, going back to the asset presentation on the association's books, if it has been determined that any asset is overvalued on the association's books, they must set up a special valuation reserve to reflect the overvalued portion. The charge to that reserve is reflected against the association's net worth position and as a result, the association's net worth position is reduced. However, that charge is also reflected through the operations stream.

But if you look at the association's net operating income for those periods, not taking into account the nonoperating charges, you will find that the association is indeed experiencing profitable operation.

Mr. BROWN. Now you are talking about Washington Federal?

Mr. PUCHALSKY. Yes, sir.

Mr. BROWN. Is there any specific rule as to when a loan must be charged off or written down?

Mr. PUCHALSKY. There is, sir. If it is determined and it is generally determined by way of an appraisal that the security for the asset on an association's books, is overvalued, then the association is required to write that portion down to the appraised valuation of the security.

Mr. BROWN. In what time frame?

Mr. PUCHALSKY. Immediately. Whenever it comes to their knowledge that an asset is overvalued in their books they are required to write it down, sir.

Mr. BROWN. Does someone else want to comment further?

We had quite a discussion about the general condition of Washington Federal. Mr. Curry, I noticed in the course of your statement, I was reading your full text while you were reading the summarized text, I noticed on page 13 you say, discussing Washington Federal, that "Washington Federal's problems are not of a materiality or severity as to warrant inclusion in the Problem Book, and the association has

not been included in the Problem Book." Is that not your best judgment and opinion, as of right now?

Mr. CURRY. Yes. That is a correct statement, sir.

Mr. BROWN. All right, I think then we ought to get into a better discussion of these categories and what the Problem Book is. And, by the way, how many institutions under your jurisdiction would you say are in the Problem Book? Do you have any idea? I don't want names or amounts of assets. I just want numbers.

Mr. CURRY. Congressman Brown, in the Second District, which covers New York, New Jersey, there are four. I do not know the total number countrywide.

With respect to the ratings on page 11 and page 12 on the statement filed with the committee, there are definitions of the 1 rating, 2 rating, 3 rating, and so forth. I would be happy to discuss this.

Mr. BROWN. Well, maybe you just ought to read those and comment further.

Mr. CURRY. This is a description of an institution which is in category 1.

An institution so rated would be free of adverse comment relating to matters of substance and would give no cause for supervisory concern.

In category 2,

An institution so rated does not measure in important respects to the elements of a "1" rating, but the nature or severity of any problem is not considered material in assessing the overall soundness or stability of the institution.

Category 3,

An institution with this rating has one or more material problems of either a temporary or continuing nature requiring close examination and supervisory attention and constant pressure for correction.

Category 4,

This rating is reserved for those institutions with major and serious problems which management appears to be unable or unwilling to correct or problems which pose a threat to its continued corporate existence. In these cases, the problems may not be insoluble, but the situation is of such large dimensions and so critical that urgent corrective action by the directorate or the Board appears necessary.

Mr. BROWN. Then is the problem book beyond that or overlapping?

Mr. CURRY. Every institution in the country at the time of the examination has a rating. It is either 1, 2, 3, or 4. Now there are institutions in those 1, 2, 3, or 4 categories—principally category 4—that are placed on what the Federal Home Loan Bank Board calls their problem list.

Mr. BROWN. The Board places all in category 4 on the problem list?

Mr. CURRY. I can't answer that. Let me check.

Mr. GOLDBERG. The officials at the Bank Board in Washington have observed the ratings and place certain institutions in what the Board calls the problem book. These are institutions that are subject to particular regulatory examining and supervisory scrutiny.

Mr. BROWN. I think Mr. Curry said in earlier testimony that you could even have an institution that would generally be rated at a 2 and be in the problem book because of some situation which was precipitous or imposed an unusual or different threat or concern?

Mr. GOLDBERG. Yes, Congressman. The supervisory rating is given after the examination and we may be aware, although this is rare,

of events which have occurred after the rating which we know are serious which would warrant inclusion in the problem book, even though we have not completed another examination that would lead to the ultimate lowering of the rating, say from 2 to 3. It is very rare, and normally it is the "4" institutions that are in the problem book.

Mr. BROWN. There was some discussion here about the regulatory authority stepping in and saying, "reduce this salary or reduce that one." To what extent does a regulatory authority get into the day-to-day operations of setting salaries, et cetera, of member institutions?

Mr. CURRY. I would say very rarely. Usually indirectly. You discuss the operating ratios of the institutions, you say, "your expense ratios are too high and we want them to come down. Give us a plan for bringing them down." And we keep pushing in that direction. But it does occur to me, Mr. Brown, that in the first place, I don't know that the Board, the Federal Home Loan Bank Board, has the statutory authority to set the salaries because these are still private financial institutions and certainly they have the authority to regulate them. I really would question whether the Board could fix salaries.

Mr. BROWN. That was part of the reason for my question. I don't think you do have the authority to say, "you must do this or that." I think you could be severely criticized for recommending specific action. Whereas you can require specific performance in other ways, such as a reduction in expense ratio, and so forth.

Mr. GOLDBERG. A salary would have to be so clearly excessive as to constitute an unsafe or an unsound practice in relation to corporate assets. And if the institution refused the supervisory guidance to reduce the salaries, which they usually wouldn't, then it would be necessary to institute formal cease-and-desist proceedings, go through a hearing before an administrative law judge, and have the order appealable to the court of appeals. So that where the institution has reached the business judgment that the salary is a reasonable one, you would have to go through these proceedings. But even then, we couldn't set the salary. We could only say that "what you have set is so clearly excessive of what is reasonable," looking at other salaries—and this is a very difficult judgment to make—that you must be wasting corporate assets, and that would be a very difficult administrative proceeding. It is possible that it could be done and there have been instances, in extreme cases, where it was so clear that we have taken some action in that area.

Mr. BROWN. Restate this briefly. We've touched on it before, but again, what steps are taken when an institution is placed on the problem list?

Mr. PUCHALSKY. When an association receives an evaluation rating of 3 or 4, subsequent to composing our supervisory letter and sending it to the board of directors, we ask for a prompt response and we also call for a meeting of that board. Under the time frame, we allow 45 days from the day we receive the examination report until the time we meet with the association's board of directors.

Following that, the district examiner is required to conduct an earlier-than-usual examination of that association, generally within 3 or 4 months—90 days or so after the meeting with the board of directors. So that the pace of the supervision and the pace of the examination is speeded up. We meet with the board; we cite the areas of con-

cern; we ask for remedial action; and examination follows when they give us the necessary assurances, and in most cases they do give us those assurances. We have a followup examination to determine that these promises have indeed been kept.

Mr. GOLDBERG. Then there are the cases where the institution will not follow the supervisory guidance. In that case, we have specific steps for instituting a cease-and-desist proceeding. We would have to give notice of an opportunity to correct the practices. We would have an APA hearing before an APA hearing judge. We have to make recommendations to the Board and the Board would have to issue a formal decision which is appealable to the court of appeals.

There is an alternative route which has been successful. That is instituting proceedings and obtaining a consent order in areas involving various types of regulatory violations. We have corrected them by either the institution of proceedings or obtaining consent to a cease-and-desist order.

And there have been a few extreme situations where we couldn't solve the problems and had to appoint a conservator who took over the institution and ran it. And there have been a few isolated instances where an institution has gone into receivership and has been liquidated.

Mr. BROWN. Mr. Curry testified that there have been only six institutions that have failed.

Mr. GOLDBERG. Since 1940, there have been six failures, six institutions to go into receivership. Fortunately, through the liquidation process, in each one of them we have generated enough money to pay back the uninsured savers who had money in the institution over and above the amount of the insurance limit.

In the four to six receiverships, there have been some classic confrontations between the Board and the stockholders in State institutions that are federally insured, as to who gets the surplus. One of the more notable accomplishments of the Board is that we have gotten the surplus for the savers and not the stockholders.

Mr. BROWN. In how many instances in the last 5 years have you had to use the cease-and-desist order in this region?

Mr. CURRY. In this region, I think on three occasions and on each occasion it turned out to be a consent to cease-and-desist. In other words, since they consented to abide by it, we didn't have to go get the court to enforce it.

Mr. BROWN. Is the experience in this region about what you expect to be true across the Nation?

Mr. CURRY. It would be speculation, Mr. Brown. I could certainly find that out.

Mr. ROSENTHAL. Mr. Mezvinsky?

Mr. MEZVINSKY. Thank you.

First, I want to be specific. The Mooney Board approved the VMT loan; am I correct in that?

Mr. CURRY. Yes.

Mr. MEZVINSKY. We don't have any problem of a predecessor. This is the Mooney Board that approved the loan in question?

Mr. CURRY. That is quite correct, sir.

Mr. MEZVINSKY. You mention the rating in the problem book. Isn't it true that in April 1975, this particular institution was rated 3? That means it's in financial trouble, with deteriorating earnings and net worth reserves. Is that correct?

Mr. GOLDBERG. I don't have the exact day but we can get that. The change in rating may not mean that there is financial trouble. It means that there are problems that are temporary or continuing that require pressure for change. And you may have a 3 institution without having any financial difficulty. It may be in superb financial shape but there may be some other practice it is engaging in that it is reluctant to change and there is need for a pressure to change. It does not necessarily have to relate to financial trouble.

Mr. MEZVINSKY. On a scale of 1 to 4, it was rated 3 in April 1975.

Mr. CURRY. Yes.

Mr. MEZVINSKY. I notice on page 16 of your statement, Mr. Curry, that the kind of corrective action you can take is No. 3, curtailment of growth pending the strengthening of net worth. Obviously you decided that they could grow and set up branches. That means you decided not to take corrective action, is that correct?

Mr. CURRY. You can curtail growth in this situation. What you are doing in that situation is you say that as you grow you have to put up at least 5 percent against that growth. And therefore if you are not growing, you really won't have to worry about putting up 5 percent against the growth. We did not and certainly as of the discussions of the moment feel that curtailment would be the solution.

I won't know until after the examination report which of these actions, if any, might be more significant. As I said earlier, we will have to look at that on the basis of whatever is disclosed and have a look at the institution.

Mr. GOLDBERG. I think it might be helpful if I point out that in periods of rapid savings growth it is not unusual for very sound institutions not to meet their net worth. Since they are growing so fast in savings they are not keeping up with it. At the time the Board made the judgment to approve this branch, there was a deficit net worth of only $248,000 in over $17 to $18 million net worth. It was so negligible with that factor alone, that it was not an alarming situation.

Now it may be, after looking at the current examination report and looking at all the indicia of concern, that a different judgment would be made as to whether there should be another branch.

Mr. MEZVINSKY. Especially if you see that the net worth shortage shows that as of the end of May 1975, you have $1,200,000. That's in the report that we have in front of us, as the chairman pointed out.

Mr. GOLDBERG. That is in the FIR. The net worth I think was considerably different.

Mr. MEZVINSKY. I mean the reserve shortage.

Based upon the rating, based upon the picture as of now, can you make a decision not to permit the branch since it is not yet in operation?

Mr. GOLDBERG. I would say that having granted the branch we could not take it away because of the various expenditures that they have made to open it. But should they apply for another branch, then after reviewing the entire financial picture, under the Board's regulation, it might be that we could raise supervisory objection to that branch and not allow future branches. It would be a question in my mind of having granted it, having had the association make certain expenditures with respect to a branch, whether we would have the legal authority to rescind such action. We would have to study that question before we could express a definitive opinion.

Mr. MEZVINSKY. One more point on the examination, based on what has been revealed, do you think we should change your procedures? Here is a situation where developers don't submit to an examination of their financial net worth. Moreover, there is no sewer permit. Why do we see such a situation? As I understand it, a grand total of $5 was spent on the credit report.

Is that the proper kind of credit report to look at? It wasn't an audited financial statement. In fact, as I understand it, it was an unaudited financial statement. In addition disbursements went directly to the contractor not to the subcontractor. Consequently you had very little control over the disbursement of funds.

With all of this background, do you think we should take a look at the procedures, not just in this specific case, but in all others?

Mr. GOLDBERG. I would like to answer that two ways. One is that we are constantly reevaluating our procedures and are in the process of doing it now for early warning detection. Two, I think there are some answers to your questions, that perhaps the examiner who had looked at that would now be in a position to express his judgment. Now that we are getting down to specifics, it becomes easier to answer by the person who worked on it. May I pass the microphone down to Mr. Cerreta?

Mr. MEZVINSKY. Of course.

Mr. ROSENTHAL. To clear the record we are now discussing the Village Mall loan.

Mr. CERRETA. Mr. Mezvinsky, just let me say that I was not the examiner in charge on that job. I can state what I believe happened.

Mr. MEZVINSKY. Can you give me your name?

Mr. CERRETA. Cerreta.

Mr. CURRY. May I be excused for a few minutes?

Mr. ROSENTHAL. We will stand in recess for 10 minutes.

[Whereupon, at 11:30 a.m., the subcommittee recessed for 10 minutes, to resume at 11:40 a.m.]

Mr. ROSENTHAL. We are back on the record.

Mr. GOLDBERG. Mr. Chairman, we may have given the impression in our previous testimony that we have attempted no supervisory action or that none is planned.

Mr. ROSENTHAL. You mean regarding Washington Federal?

Mr. GOLDBERG. Yes. This is a unique area. Although we wish to cooperate in every other area, we would like, if the subcommittee is interested, to present this in executive session. We are concerned that discussing this publicly could affect the due process rights of individuals involved or who could be involved and jeopardize the chances of success should we wish to take some action.

The Board would be willing to discuss what it has done and what could be done in the future specifically when we go into executive session. We ask that this be the one area that we don't have to comment on in public because we are concerned with the legal rights of both which could prejudice us and prejudice other individuals——

Mr. ROSENTHAL. Are you referring to pending action?

Mr. GOLDBERG. Certain things that we are doing, have done, and could want to do in the future. And this is an area that we would hope, if you are interested, to express our views in executive session.

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Mr. ROSENTHAL. Well, the subcommittee will have to take that under consideration.

Mr. GOLDBERG. Thank you, Mr. Chairman.

Mr. ROSENTHAL. Mr. Mezvinsky?

Mr. MEZVINSKY. I thought we would spend just a few moments to discuss the specifics and put them on the record. Let's talk about the credit report. I understand that in the loan commitment agreement, the developers agreed to cooperate with any credit investigation. I also have a report showing that the total cost of the credit investigation was about $5. There really wasn't any investigation. Is that true?

Mr. CERRETA. I don't know what the cost of the credit report was. They probably were $5 credit reports.

Mr. MEZVINSKY. Don't you look at them?

Mr. CERRETA. That's not the end result of the credit investigation.

Mr. MEZVINSKY. Did they submit an audited financial statement?

Mr. CERRETA. I'm sure it was not an audited financial statement. It was a financial statement. And again that is not the end result. The Association has to evaluate the information. They have to verify some of that information.

Mr. MEZVINSKY. Next item, appraisals. I gather that the examiner's notes of the 1975 examination stated that Washington Federal failed to obtain an adequate appraisal to justify their loans. How extensive was this failure on the part of Washington Federal?

Mr. CERRETA. This is in the examination report?

Mr. MEZVINSKY. Page 5 of the 1975 examination report of Washington Federal.

Mr. CERRETA. I'm really not sure if that would be on page 5.

Mr. MEZVINSKY. I gather it is the examiner's notes that were made regarding—page 5 of the examiner's notes, specifically.

Mr. CERRETA. I'm still not sure what notes you are referring to.

Mr. MEZVINSKY. Somewhere in your examination notes, specifically talking about appraisals, it states that Washington Federal failed to obtain adequate appraisals to justify their loans. How extensive was the failure? And if that isn't the case, then please inform the committee.

Mr. CERRETA. The Association obtained two independent appraisals on all their loans. I'm still not sure what you are referring to. Are you referring to your own overall view of the workpapers?

Mr. MEZVINSKY. I have in front of me the exception sheet, GF–1 of the 1975 report. In the middle of that it specifically talks about the problems of appraisals and independent appraisals. Are you aware of that?

Mr. CERRETA. What was the examiner's conclusion on that?

Mr. MEZVINSKY. Specifically, that they did an inadequate appraisal.

Mr. CERRETA. There is a disposition alongside of it, I believe. I don't have that paper in front of me.

Mr. MEZVINSKY. We will continue then.

Mr. GOLDBERG. I think it would be helpful if we could——

Mr. MEZVINSKY. All right. GF–1, exception sheet.

It says here that the loan was approved without an appraisal report as required under and then it cites 513.17–1C.

Mr. PLAPINGER. Was that with respect to a specific loan?

Mr. MEZVINSKY. It is about this loan. We are talking about Washington Federal's loan.

Mr. CERRETA. Yes. You are right. I see it here.

Mr. MEZVINSKY. The key point is, how extensive was this failure?

Mr. CERRETA. Congressman, I believe the examiner in charge corrected the examiner who prepared this exception here. The examiner implied that an independent appraisal should be received before the loan was approved. But we require that independent appraisals be received before the loan is made.

Mr. MEZVINSKY. So you are saying that subsequently it was corrected, is that what you are saying?

Mr. CERRETA. This does not say that the independent appraisal was not received before the loan was made. It says that there was a commitment issued and the loan was approved subject to receipt of the appraisal which is in accordance with our regulations.

Mr. MEZVINSKY. I will follow up on that. But I have a third point. Merritt & Harris, as I understand it, recommended disbursement of funds specifically to Washington Federal. On March 8, 1974, Merritt & Harris recommended that Washington Federal suspend further disbursements until the sewer impasse was resolved. And Washington Federal continued to disburse over $1 million after this date despite the lack of the sewer plan.

Mr. CERRETA. That is correct. However the sewer plan was for the adjacent property, the Village Mall Towers.

Mr. MEZVINSKY. It is the same sewer line.

Mr. CERRETA. As to the Association's loan, the borrowers had approval on their loan for sewer hookups to the sewer.

Mr. MEZVINSKY. But you've got Merritt & Harris recommending not to disburse any further——

Mr. CERRETA. Until they were satisfied, that's right.

Mr. MEZVINSKY. They didn't recommend—do you have any evidence——

Mr. CERRETA. They did subsequently——

Mr. MEZVINSKY. They did? Where?

Mr. CERRETA. Recommend that the disbursements be made.

Mr. MEZVINSKY. Do you have any evidence to that?

Mr. CERRETA. Yes, sir. I think it was only 5 days later that they made the recommendation that a certain amount of money be disbursed. I don't remember how much it was.

Mr. MEZVINSKY. What about the initial sewer plans? Did they indicate a review of that? I think all this has to be put in the record and if you have some evidence of that, I'm not going to take any more time on that specific point. But it is clear that we've got some problems with this particular loan. There are some conflicts.

I guess that the reason I am bothered by this is that I see a deeper problem, the conflict of interest problem. As I understand it you only receive a director's fee by sitting on the board of directors of the bank, is that correct?

Mr. CURRY. Let me explain that Mr. Mooney was on the board of directors of the Federal Home Loan Bank of New York from 1969 to 1972. That board of directors met monthly for approximately 3 hours. The fee at that time, I believe, and I can certainly check this and give you the correct figure. Now I'm going to give it to you as I remember it. It was either $100 or $150 per meeting.

Mr. MEZVINSKY. That's on the New York Bank Board?

Mr. CURRY. The New York Bank Board.

Mr. MEZVINSKY. Are you at all troubled by the idea that people sitting on the bank board are paid to make decisions affecting their own associations and their own institutions?

Mr. CURRY. Sir, they do not make any decisions affecting their own associations, in reality.

Mr. MEZVINSKY. How don't they? They are the policymakers, aren't they?

Mr. CURRY. No, sir.

Mr. MEZVINSKY. What are they?

Mr. CURRY. They are directors, but as I explained earlier, they are not permitted to do anything other than pursuant to regulations of the Federal Home Loan Bank Board. Now, in that we are concerned primarily with the advancing of loans to savings and loan associations for housing or to meet withdrawals. The terms and conditions and rates on those advances can be set within limitations by the bank's board of directors. But the Federal Home Loan Bank Board can set them all up if they wish to do so.

Mr. GOLDBERG. It may be very helpful to clear up confusion if I can briefly make one comment. The Federal Home Loan Bank of New York as well as the Federal home loan banks in the other 11 regions have no supervisory responsibilities at all. They have no responsibilities in application matters. All supervisory application matters are vested in the Board and Board employees. However, the president of the bank, as well as one or two or three of his officers, have been designated by the Board to act as supervisory agents. When they act as supervisory agents, they report only to the Board; that is, the Federal Home Loan Bank Board in Washington and the Board staff in Washington. They may not discuss any application matters or supervisory matters with the board of directors of the bank.

The board of directors of the bank function only in the credit allocation area with respect to advances. So there is a complete and total separation between the directors of the Federal home loan bank who are participating only in the credit allocation function, the advance function. That is completely separated from the president of the bank and some of his officers who are acting in a supervisory role and who only discuss their functions in such role with the Board in Washington and its staff in Washington.

So we keep the application and supervisory functions completely apart from the bank's directors, and there is no input, participation, or involvement of the board of directors of the bank in the supervisory or application role.

Mr. MEZVINSKY. Mr. Chairman, I think I will defer further questions until later.

Mr. ROSENTHAL. Let us now discuss, if we can open the two areas of specific inquiry, that is the two loans to Dr. Bergman and the Village Mall loan, which we touched upon and into which I want to examine in greater detail.

Is Mr. Cerreta the man who was examining then, Washington Federal during the time of both of these loans?

Mr. CERRETA. You are referring to Dr. Bergman's loans?

Mr. ROSENTHAL. To Dr. Bergman's two loans and the Village Mall loan.

Mr. CERRETA. I was not the examiner.

Mr. ROSENTHAL. Who was the examiner's supervisor during that period of time?

Mr. CERRETA. I was.

Mr. ROSENTHAL. If you were the supervisor, you should know as much as anyone about these loans?

Mr. CERRETA. I believe so, among the examiners.

Mr. ROSENTHAL. I just want to understand, was your examination made after the loan commitment was given and the matter was closed, or did you at any time have an option to wave a red flag and say that you don't think this was such a good loan?

Mr. CERRETA. You're talking about Village Mall Townhouse?

Mr. ROSENTHAL. Take either one.

Mr. CERRETA. Village Mall, there was a commitment prior to examination. And if there is a commitment, there is a possibility that it might be reviewed. We only sample whatever loans they make or whatever commitments they have.

Mr. ROSENTHAL. Was the Village Mall commitment the largest one Washington Federal ever made?

Mr. CERRETA. No.

Mr. ROSENTHAL. Which one was larger?

Mr. CERRETA. I know there are several larger. In fact there were some made during that same examination period. One was, I think, $6,750,000.

Mr. ROSENTHAL. Who was that commitment made to?

Mr. CERRETA. If I remember correctly, that was Riverview Apartments.

Mr. ROSENTHAL. Let's deal with the Village Mall first.

Can you refer to a file on the Village Mall loan?

Mr. CERRETA. Yes, sir.

Mr. ROSENTHAL. Do you have the file in front of you?

Mr. CERRETA. Yes, sir.

Mr. ROSENTHAL. Tell us about the background of Newmark and Rosano as of the time they applied to Washington Federal for a $5 million loan.

Mr. CERRETA. At the time they applied to Washington Federal?

Mr. ROSENTHAL. Yes.

Mr. CERRETA. They also had another condominium project ongoing. That was the Village Mall at Hillcrest, I believe that was.

Mr. ROSENTHAL. Is that in default?

Mr. CERRETA. I think all of their projects are in default now.

Mr. ROSENTHAL. Well, tell us about their experiences before they built the Village Mall at Hillcrest. What kind of background check was made on them?

Mr. CERRETA. They built two family apartment houses in Queens.

Mr. ROSENTHAL. Two family apartment houses?

Mr. CERRETA. Yes.

Mr. ROSENTHAL. Two family houses?

Mr. CERRETA. Two family houses.

Mr. ROSENTHAL. Prior to the Village Mall condominiums, the one of Union Turnpike and the one of Bayside, is it true that these people had never built anything higher than two stories?

Mr. CERRETA. I can't say for sure.

Mr. ROSENTHAL. Well, look through the file. If you can give us an example, tell us.

Mr. CERRETA. The files, I don't think, would support any answer to the contrary.

Mr. ROSENTHAL. At the time they made the commitment to Village Mall, had they at that time written down these other loans or losses?

Mr. CERRETA. I can't say for the other loans, sir. I don't think they were in default, though, at that time.

Mr. ROSENTHAL. Was their net worth below the requirement at the time they made this commitment?

Mr. CERRETA. The association's, sir?

Mr. ROSENTHAL. Yes.

Mr. CERRETA. No; I don't believe so.

Mr. ROSENTHAL. Had they written down all the other bad loans, at that time?

Mr. CERRETA. Anything that was overvalued on their books, yes.

Mr. ROSENTHAL. In other words, what I am trying to discover, was this a healthy, vibrant, vital association at the time they made this commitment or one that had problems?

Mr. CERRETA. At the time of the commitment, I don't recall having had any problems with the association.

Mr. ROSENTHAL. When was the commitment made?

Mr. CERRETA. In December 1972.

Mr. ROSENTHAL. At that time, did they own the mortgages on properties that were subsequently devalued?

Mr. CERRETA. And they were devalued, right.

Mr. ROSENTHAL. Right. And did you look at those properties that were being carried on their books at full value?

Mr. CERRETA. We inspect some of them, yes.

Mr. ROSENTHAL. I don't mean that you had to go out and look at all the bad properties on Staten Island, but that you did look at Washington Federal's portfolio listing?

Mr. CERRETA. Yes.

Mr. ROSENTHAL. At that time, did you anticipate that they were going to devalue these properties or write them down?

Mr. CERRETA. Are you talking about additional properties that were devalued after that?

Mr. ROSENTHAL. Yes; of course. When they made the loan to Newmark and Rosano, Washington Federal hadn't written down anything.

Mr. CERRETA. I don't believe that is so.

Mr. ROSENTHAL. You're the one that just told me that.

Mr. CERRETA. No; I didn't say that.

Mr. ROSENTHAL. Why don't we reach an agreement here? What was the date they made the commitment for the "Village Mall" at Bayside?

Mr. CERRETA. December 1972.

Mr. ROSENTHAL. And as of December 1972, had they written down or devalued any properties?

Mr. CERRETA. I'm not sure, but I think they had at that point.

Mr. ROSENTHAL. Were they then entering the threshhold of being below the minimum requirements for net worth?

Mr. CERRETA. I wouldn't say that.

Mr. ROSENTHAL. When did they reach that level?

Mr. CERRETA. When they first fell below their net worth? March 1975.

Mr. ROSENTHAL. Were there any warning signals about the efficacy of this bank, of this institution? Are you unhappy with this association?

Mr. CERRETA. I couldn't answer that.

Mr. ROSENTHAL. Let me rephrase it. Are you unhappy with the condition of this institution today?

Mr. CERRETA. I don't think that is my determination.

Mr. ROSENTHAL. How do you feel about it?

Mr. CERRETA. I don't think I should answer that.

Mr. ROSENTHAL. Why not?

Mr. CERRETA. I don't think I can.

Mr. ROSENTHAL. Your superiors want to go into executive session to tell us about it. They don't want to tell us about it in public.

Mr. BROWN. Now just a minute. In Mr. Curry's statement, I'll repeat the language. I asked him in direct testimony to repeat it. He said, "Washington Federal's problems are not of a materiality or severity to warrant inclusion in the Problem Book." And the Association has not been included in the Problem Book. He has explained the Problem Book.

If there was a problem of the materiality or the severity that you are suggesting, they would be in the Problem Book, according to testimony.

Mr. ROSENTHAL. Yes, Mr. Mezvinsky?

Mr. MEZVINSKY. The problem, I would say, Mr. Brown, is that I could accept that, but now we are getting a report that they want to go into executive session because there may be some——

Mr. BROWN. No. What the request was—that with respect to specific actions that they might be contemplating taking, are taking, and so forth, that they would prefer to discuss that in executive session because it might have the effect of jeopardizing or in some way compromising the due process of law and rights of the individuals involved or institutions involved, as I understand it.

Mr. ROSENTHAL. Let me see if we can straighten this out. We're not really interested in the condition of your mind either now or at that time because that would be an inappropriate question.

I want to know, for the record, as of December 1972, did you as the examiner, see any warning signals, indicating that this bank ought to be prudent and cautious in its loan transactions?

Mr. CERRETA. Well, we couldn't answer for December 1972 because the next time we were in there was June 1973.

Mr. ROSENTHAL. When were you in there prior to the making of the commitment to VMT in December 1972?

Mr. CERRETA. Prior to that? I think it was October, no——

Mr. ROSENTHAL. Was it in October 1972?

Mr. CERRETA. No, July 1972.

Mr. ROSENTHAL. Can you or any of your colleagues tell us, what your official impression was of that institution in July 1972?

Mr. CERRETA. I couldn't answer that.

Mr. CURRY. Mr. Chairman, going back to an earlier question, did we have any concern for this institution? I suppose I could answer that, first of all, in these terms. We have concerns about every institution——

Mr. ROSENTHAL. Please don't do that to us now.

Mr. CURRY. I will narrow it down. I must confess that when I note that an institution is holding mortgages on properties in certain areas of New York City and knowing something about the history of those mortgages, that even though back in 1972 or back in 1965 they were, indeed, current, you still have concerns.

Now we did point out, I think, in one supervisory communication, and I'll ask Mr. Puchalski to get the exact date. But we are concerned when there is undue concentration, lending on multifamily or commercial-type properties.

Mr. ROSENTHAL. Mr. Curry, maybe I should direct my question to you because I think they are more a matter of policy. What I'm really trying to find out, in absolute candor, is whether in December 1972 when they made this commitment, should this institution have been acting with particular prudence, concern, restraint or conservatism? Should any of those factors be considered by their board of directors? Considering the extent of this loan, $5 million, and the fact that this project was the second highrise being built by these two operators, this loan seems something unusual to me.

Mr. CURRY. I certainly share your view that if you have an institution whose experience either in present management or past management with these type properties has not been the happiest, certainly I would proceed with great caution.

However, I do believe, Mr. Chairman, that at the time the commitment was issued, that the facts the association had before it, I don't know if they were all the facts, seemed to dictate that this was not a bad loan.

Mr. ROSENTHAL. Well, let me tell you some of the facts they had before then, and you tell me if you would have made a similar judgment. I know that I would have been fired if I made that decision.

They got a credit report on Newmark and Rosano which cost $5, on a $5 million loan. Does that do anything to you? I tell you, before I'd lend anybody $500, I'd take a second quick look.

Mr. CURRY. A $5 credit report is worth $5.

Mr. ROSENTHAL. Right.

Mr. CURRY. Or maybe not that much.

Mr. ROSENTHAL. If you have a copy of that credit report in your file, tell us what it says.

Mr. CURRY. I've never seen it.

Mr. ROSENTHAL. Why don't you take a look at it? I have respect for your judgment. Take a look at it. See how it shakes you, for a $5 million loan. Read it to us.

Mr. CURRY. "Credit record. No credit shown on inquiry."

Mr. ROSENTHAL. We can't hear you.

Mr. CURRY. Well, here's what it says. I'm reading it for the first time. "No credit shown on inquiry. We corresponded with subject and tried to contact him at office on several occasions but to date have received no reply." Business phone and so forth. Personal, nothing. Litigation, no litigation at the time.

In his financial statement, if I've been advised correctly, he did list some banks——

Mr. ROSENTHAL. No, no, no. Read what it says about cooperation. Have you read everything on that page, on that $5 page?

Mr. CURRY. It says that the borrowers are presumed—that the credit agency tried to contact them on several occasions but they never received a reply.

Mr. ROSENTHAL. What do you think about that?

Mr. CURRY. I must confess, that would draw up a flag in front of my face.

Mr. ROSENTHAL. Me, too. I tell you one thing, I wouldn't give $5 million based on that.

Mr. CURRY. I believe, Mr. Chairman, there were other investigations.

Mr. ROSENTHAL. Let's look at the other investigations. I accept your invitation. Give us the financial statement they relied on.

Mr. PUCHALSKY. Chairman Rosenthal——

Mr. ROSENTHAL. I'd like to have Mr. Curry's opinion. He's maybe one step removed from this situation.

Mr. CURRY. Mr. Chairman, as I indicated earlier, I don't have the details. I'm advised that in terms of the financial report given by the builders by Washington Federal——

Mr. ROSENTHAL. Do you have a copy of it? Let's look at it.

Mr. CURRY. I have before me a statement of condition, August 31, 1973.

Mr. MEZVINSKY. 1973, that's after the loan. You have to have it before.

Mr. ROSENTHAL. You don't have any earlier statement?

Mr. MEZVINSKY. We have nothing before?

Mr. PLAPINGER. Mr. Mezvinsky, the loan was made in October 1973.

Mr. ROSENTHAL. We are talking about how this commitment came to be. Is there anything in your regulations about mortgage officers having dinner at the home of perspective borrowers?

Mr. CURRY. I've never seen anything in the regulations that would specifically relate to that.

Mr. ROSENTHAL. What do you think about such social relationships as the head of the second region Federal Home Loan Bank?

Mr. CURRY. Well, Mr. Chairman, I do not necessarily conclude that for an association officer to have dinner with somebody with whom he is doing business is bad. In any event, I could not agree that the Government or any arm of the Government should really dictate these kind of specifics in terms of the association.

I certainly would agree that if there were any collusion, somebody should be put in jail. That's quite a different thing from sitting down and having dinner, I think.

Mr. BROWN. In connection with your examination of this loan and as you reviewed it and all, have you found anything that would suggest that there was collusion, improper practices, between the lender and the borrower in this instance?

Mr. CERRETA. Nothing at all.

Mr. BROWN. Between the lender and the appraiser?

Mr. CERRETA. Nothing at all.

Mr. BROWN. Between the lender and the consulting engineers who were basically the dispensing and disbursement approving officers?

Mr. CERRETA. No.

Mr. BROWN. Now, beyond those that I have specifically asked about, did you find any improper collusion or practices, and so forth?

Mr. CERRETA. No.

Mr. ROSENTHAL. What we are doing, I appreciate the line of questioning, and I appreciate the answers, but the purpose of this hearing is to inquire into your ability to make that inquiry, whether you just sat back in a rather traditional sense, and merely accepted everything sent to you regarding the VMT loan.

I want to review the VMT loan material item by item; that is, the credit report doesn't impress you, Mr. Curry, anymore than it impresses me.

Let's review the financial statement. Let's see who prepared it, who authenticated it, what does it say, and what are the assets listed in there? I think we have to look beyond the face of these documents.

Mr. GOLDBERG. We are not certain we have in the agency files the actual financial statements that the associations have. We have some.

Mr. ROSENTHAL. What did you say?

Mr. GOLDBERG. We are not certain that we have in the Board's files the actual financial statements that the association received from the two builders. We have certain documents but we are not certain that these are the only documents that the association received.

Mr. ROSENTHAL. Let me read the letter by Louis Goldberg and Company, P.C., Professional Corporation, dated October 13, 1972, in which Mr. Goldberg and Company says, "The normal auditing procedures of confirmation have not been followed due to the lack of time."

Do you know what that means? Does anybody at your table know what that means?

Mr. CERRETA. That means that the statement is unaudited.

Mr. ROSENTHAL. Well, I know that. But what else does it mean? It means that Mr. Goldberg and Company, P.C., are merely transmitting information given to them by Newmark and Rosano. Isn't that what it means? That they made no independent verification of any of the representations made by Newmark and Rosano? Isn't that what it means?

Mr. CERRETA. Goldberg did not.

Mr. ROSENTHAL. Goldberg did not. And you did not. And no one else who gave out the $5 million of which the public is the insurer has ever independently investigated anything.

Mr. CERRETA. I can't say that, sir.

Mr. ROSENTHAL. Tell me something that you looked at yourself.

Mr. CERRETA. That I looked at myself?

Mr. ROSENTHAL. Yes. Anything. Is it common for an institution in this city to make a loan before all the permits are available or filed? Is that a common practice in this city?

Mr. CERRETA. It is a common practice to have all those permits.

Mr. ROSENTHAL. Of course it is. Is it a common practice for an institution to make disbursements before all the certificates have been issued? Why did you let these payments go forward without the sewer permit being issued which caused the default of this job?

Mr. CERRETA. The sewer permit was for another loan that the association was not involved in.

Mr. ROSENTHAL. But you could not get a certificate for occupancy for these 141 units without a sewer permit.

Mr. CERRETA. I'm not sure of that.

Mr. ROSENTHAL. You're not sure of it?

Mr. CERRETA. This is another loan and it is another sewer permit.

Mr. ROSENTHAL. The same sewer transcended both jobs.

Mr. CERRETA. The sewer that was going back to the Towers went through the property that this loan was secured by.

Mr. ROSENTHAL. What did you say?

Mr. CERRETA. The sewer that was supposed to be going to the Towers went through the property this loan was secured by.

Mr. ROSENTHAL. That's correct. Is it common practice in the city of New York to complete a loan and make disbursements before all the official permits have been issued? Is that the common practice in our city?

Mr. CERRETA. To get all the permits? Yes.

Mr. ROSENTHAL. Yes. Now why did Washington Federal make payments on this loan without all the permits being issued?

Mr. CERRETA. On this loan, all the permits were issued.

Mr. ROSENTHAL. That is not correct. There is no sewer permit for this loan. For this job.

Mr. CERRETA. For this job?

Mr. ROSENTHAL. If there is, give us a copy of it.

Mr. BROWN. Mr. Chairman, you are questioning this witness as though he were an officer of Washington Federal.

Mr. ROSENTHAL. Do you have a duplicate file or a file that fairly represents everything that Washington Federal has on this loan?

Mr. CERRETA. I would say not.

Mr. ROSENTHAL. No. Would you tell an institution that you supervise not to make any payout until all the permits are issued?

Mr. CERRETA. That would be common.

Mr. ROSENTHAL. The same thing happened with the Dr. Bergman loan. They had no certificate from the State to operate a nursing home and Washington Federal paid out money.

Mr. CERRETA. Again, that's not exactly true.

Mr. ROSENTHAL. Well, you tell me what's——

Mr. CERRETA. They had approval on the Dr. Bergman loan and they had the building permit.

Mr. ROSENTHAL. To this day, on the two loans made by Washington Federal to Dr. Bergman, did he have a license to operate a nursing home?

Mr. CERRETA. On one of them, they are operating as a nursing home.

Mr. ROSENTHAL. What about the other loan?

Mr. CERRETA. The other one they haven't completed.

Mr. ROSENTHAL. Has the loan been disbursed?

Mr. CERRETA. Only partially.

Mr. ROSENTHAL. Why should 5 cents have been paid out, if they don't have all the official permits?

Mr. CERRETA. This is the way you construct a nursing home. You cannot get the final license until after the building is completed.

Mr. ROSENTHAL. Let me read to you a letter dated March 8, 1974, from Merritt & Harris. It was addressed to the Washington Federal Savings & Loan Association. A copy was sent to the Bankers Trust Co., March 8, 1974—

An inspection of the project on March 1, 1974, showed construction progress to be as follows: The developer has apparently not obtained final approval from the building department for the storm and sanitary sewer system for the project and the existing sewer relocation, although a building permit has already been issued. These systems are being treated as an overall package for the townhouses

and the village mall tower project on the adjacent site. The design engineer for this work is Mr. Manuel Elkin although we have received no plans prepared by him for this review. The approval of this work affects the entire townhouse project. We have had considerable difficulty in obtaining information on this matter and we request your assistance in obtaining the complete details from the developer.

Who is Merritt & Harris?

Mr. CERRETA. The construction engineers for the association.

Mr. ROSENTHAL. Is it a reputable organization?

Mr. CERRETA. I couldn't answer that.

Mr. MEZVINSKY. Wait a minute. Why can't you answer that question?

Mr. CERRETA. I have no information to the contrary.

Mr. MEZVINSKY. So then as far as you know, they are reputable?

Mr. ROSENTHAL. They said here that the sewer system is being treated as one unit for both the high rise and the townhouses.

Mr. CERRETA. That is correct.

Mr. ROSENTHAL. Have you told this subcommittee that it is common practice in the city of New York for a bank or an association not to disburse funds until all the permits have been issued? Is that correct?

Mr. CERRETA. That is correct.

Mr. ROSENTHAL. In this case, how much money did Washington Federal disburse without a sewer permit being available?

Mr. CERRETA. Up to this point, I believe $685,000 in approved advances.

Mr. ROSENTHAL. Mr. Curry, have you heard this testimony?

Mr. CURRY. Yes, sir.

Mr. ROSENTHAL. Is it your understanding that in the city of New York banks or institutions do not disburse money until all governmental certificates and permits have been issued?

Mr. CURRY. I believe that is the common practice.

Mr. ROSENTHAL. Do you think this bank was remiss in its responsibilities to disburse $600,000 without requiring the developer to first obtain a sewer permit which as of today has not been issued?

Mr. CURRY. Yes; I would think so.

Mr. ROSENTHAL. And as a result of that, 141 people are $600,000 out of pocket because this bank went ahead with this deal?

Mr. CURRY. Well, I don't know quite how you associate the two. I have never understood and no one has been able to explain to me the confusion that exists about the sewer connection. I am told that they did, in fact, have a sewer permit for the 141 units.

Mr. ROSENTHAL. Do you want to read this letter?

Mr. CURRY. I heard the letter. And then I am told that was intimately involved in the sewer permit for the highrise portion, the separate project. I would say that if there was any question, if there were any question about the ability to obtain a sewer permit, I certainly would not make the loan.

Mr. ROSENTHAL. If I were working in a bank and there were questions about a sewer permit, I'd say "Hold it, stop everything."

Why give money to a project that may not be finished. That is exactly what happened?

Mr. MEZVINSKY. Mr. Chairman, is it a standard practice to have a financial statement or a $5 examination of credit? Is that a standard practice?

Mr. CURRY. I would say that. Let's talk first of all about projects of $5 million because——

Mr. MEZVINSKY. OK. Let's talk about a project of $5 million.

Mr. CURRY. Credit reports vary in accordance with what kind of property is involved. I would say that most institutions or a lot of lenders for whatever they paid for it would want more information and would follow up on information.

Mr. GOLDBERG. Congressman, I think it's also significant perhaps to point out two things. If that's all there was, the red flag would have been waving very clearly, except that we did not come in here until July 1974 and these events occurred between the two examinations. So we would not have caught this. But I think it is significant——

Mr. MEZVINSKY. In July 1974 you came in?

Mr. GOLDBERG. June 1974 was the examination. The loan was made in October 1973. The commitment was given in December 1972.

Mr. MEZVINSKY. What was the date of that financial report? I thought it was dated——

Mr. GOLDBERG. We came in in June 1974.

Mr. MEZVINSKY. You came in in June 1974 but the actual credit report for $5 was in 1973.

Mr. GOLDBERG. What happens is the commitment was made in December 1972 subject to credit and appraisals. And they were received some time in 1973 and the loan was made in October 1973. And it would be at that point that we came in in July examination and we focused on this.

My point is, in addition to the other items, the records will reflect that the builders submitted and paid $12,000 for two appraisals by two independent appraisers selected by the Association, who came in with what the examiner considered to be reasonable appraisals. In addition to which, there was evidence in the records of the Association that they had checked with some of the banks that did business with the builder. And, of course, the third point is that the Association had sold 60 percent participation in this to another bank.

So you have the independent appraisals, the hiring of a firm of engineers who were intended to monitor these projects, the utilization of counsel, and apparently additional checks were made by the Association to verify some of the information in the financial statements.

However, from our point of view as an agency, we didn't come in here in our examination until June, July and August of 1974. The disbursements of moneys occurred between our two examinations.

Mr. ROSENTHAL. Does the Board have any recommended procedures for associations to follow in disbursing funds to subcontractors? Is there such a thing as seeking a waiver of a lien? Can any of you answer this question?

Mr. PUCHALSKY. Please repeat the question.

Mr. ROSENTHAL. Does the Board have any regulations or recommended guidelines concerning the practice an association should follow in making disbursements to subcontractors; to satisfy subcontractor payments, so that liens are not filed?

Mr. CURRY. Mr. Chairman, in terms of the regulations, I'll answer. I think there are some other instructions contained in the examiners manuals.

The Association in terms of their payouts is neither, I think under the regulations, they can either bring the title down or the voucher system.

The regulations themselves were not violated by the particular procedure. But I do seem to recall that there was something in the examining process that suggested that perhaps a voucher system was a better system.

However, the drawdown schedule in this particular case is, I believe, standard operating procedure among institutions and builders in the New York area.

Mr. ROSENTHAL. In other words, are payments made to the general contractor without regard to whether or not the subcontractors are being paid?

Mr. CURRY. Well, they would never make an advance without the title company bringing that title down to see whether any liens had been filed.

Mr. ROSENTHAL. And, in addition to the foregoing, of all events that transpired regarding the VMT development, the title company made a mistake, and there was a defect in this title.

Mr. CURRY. That's correct. A very large title company. There will be a lot of litigation about this before it is over. The title company certified a clear title when in fact it appears the lender did not have the first mortgage.

Mr. DRINAN. If the gentleman would yield? Another astonishing factor is that there was a second mortgage on the property of $41 million. Has that been disclosed before it was disclosed here today?

Mr. CURRY. I think it turned up in one of the title reports.

Mr. DRINAN. That's public information today for the first time, that there was a second mortgage unknown to the Association, of $41 million?

Mr. CURRY. The Association learned about it——

Mr. DRINAN. The Association may have but we followed this case closely and this was new information to me today. Has it been in the public domain before?

Mr. PLAPINGER. The subcommittee staff has certainly known.

Mr. DRINAN. They might have but I am asking whether anybody has publicly disclosed this? The 141 people out at Bayside now know that this bank blew the fact, didn't know the fact that there was a second mortgage on this property which wasn't even owned and the second mortgage was $41 million.

Mr. CERRETA. Congressman, the existence of the second mortgage became known in August 1974. It was disclosed when the Association asked for a "bringdown" on the title, to support an additional advance. Because the second mortgage was disclosed and also additional mechanics' liens, all disbursements stopped. That was the first instance of the $41 million——

Mr. DRINAN. Mr. Chairman, maybe we ought to be investigating the people who gave up the $41 million second mortgage?

Mr. ROSENTHAL. That's coming next.

Mr. CERRETA. That was merely additional collateral that one of the lenders took.

Mr. ROSENTHAL. Mr. Curry, are you aware that one of the directors of this Association wrote a "Dear Lou" letter to the attorney general

of the State of New York asking him not to intervene in the Village Mall matter?

Mr. CURRY. No. First time I've heard that.

Mr. ROSENTHAL. Would you describe this Board as a politically well-connected board of directors?

Mr. CURRY. Of Washington Federal?

Mr. ROSENTHAL. Yes.

Mr. CURRY. In all honesty, I see a name on there which I see in the newspapers connected with political organizations around this town and that's about the extent of my knowledge.

Mr. ROSENTHAL. Do you know whether or not Newmark and Rosano applied to any other bank for this loan and was turned down?

Mr. CURRY. I do not know.

Mr. ROSENTHAL. Does it seem unusual that the developers should seek such a large loan from an institution as small as Washington Federal?

Mr. CURRY. No, I wouldn't think that. This is over a half-billion dollars, a little over $500 million, and there would be no reason why I think they might conclude that they must go to a larger institution for this type loan.

Mr. ROSENTHAL. Are you satisfied that your organization's supervision of Washington Federal bank and the Village Mall loan and the two Bergman loans was appropriate and adequate?

Mr. CURRY. I'm not trying to evade your question. Of course, I'm never quite satisfied in an ultimate sense with anything because we are constantly trying to improve our procedures. I can tell you this, Mr. Chairman, and I'm not trying to evade the question.

But we have a loan which went bad. It does appear to me that a number of mistakes were made in connection with that loan. But the institution, in making the loan, appears on the face of the examination to have met the criteria established by the Board in terms of the things that they must do.

And I regret very much that the loan was bad. It's the only condominum in this area, I think, in this area that has gone bad. Of course, we don't have many condominiums, such as the case in Florida and perhaps Massachusetts and a few other areas.

The problems of this institution in this matter or any other matter are still there in terms of our supervisory effort. They haven't gone away.

Mr. ROSENTHAL. If Washington Federal hadn't made this loan, 141 families wouldn't be out $600,000.

Mr. CURRY. Well, if this loan had never been made, then I don't think the people would have been out $600,000.

Mr. ROSENTHAL. If Washington Federal had experienced more stringent supervision by your Board, this loan might not have been made.

Mr. CURRY. Well, I think, Mr. Chairman, that our supervision, particularly our supervision in the second district has been tough.

Mr. ROSENTHAL. If I were the boss and an examiner said to me "I've relied on a $5 credit report to give a $5 million loan," I'd call a meeting with the personnel department.

Mr. CURRY. There are, of course, a number of items which the Association must obtain in connection with making a loan. And the

credit report requirement doesn't say what the depth of it or the magnitude of it——

Mr. ROSENTHAL. The only positive statement in the credit report was that they were uncooperative.

Mr. CURRY. No. I am talking about the Board's regulations now.

Mr. ROSENTHAL. Does the Board have a policy that requires the developer to maintain sufficient equity to assure his economic interest in the project? In other words, did this developer have an economic interest in the project other than the land?

Mr. CURRY. I do not know.

Mr. ROSENTHAL. Does anybody at your table know that?

Mr. PUCHALSKY. Our lending regulations prescribe loan-to-value ratios. The loan cannot exceed a specified percentage of the value of security. The land itself was valued in excess of $1 million—$1.7 million.

Mr. ROSENTHAL. And how much did he pay for it?

Mr. PUCHALSKY. That information is not available at this point.

Mr. ROSENTHAL. Would the $1.7 million value of the land be sufficient to insure the Association's investment in the project and that the loan would be repaid?

Mr. PUCHALSKY. I assume that subsequent to the purchase of that land, the value of that land increased many times.

Mr. ROSENTHAL. I am talking about at the time they made the commitment, the time they made the payout, was the value of the land enough to assure the amount of money that they paid out?

Mr. PUCHALSKY. Based on the facts available to me now, I would say yes.

Mr. ROSENTHAL. As of today how much is the VMT property with the uncompleted construction worth?

Mr. PUCHALSKY. There is a new appraisal being made currently. We will have that information very shortly.

Mr. ROSENTHAL. Have they obtained a sewer permit as of today?

Mr. PUCHALSKY. Not to my knowledge.

Mr. ROSENTHAL. Then it's worthless, isn't it?

Mr. PUCHALSKY. Well, I wouldn't characterize it as being worthless. Its salability is questionable.

Mr. ROSENTHAL. You could use it for a marihuana smoker's clubhouse. You could use it for baseball games. What could you use it for?

Mr. PUCHALSKY. Hopefully, the owners of the land will be able to secure a permit to run a sewer through there.

Mr. ROSENTHAL. Mr. Drinan?

Mr. DRINAN. Thank you, Mr. Chairman.

When you people did a survey of the bank, I have the report here for 1974, was it possible for you people to do anything at that time? Let me just read what was concluded: "Over the past 2 years, the Association has been heavily involved in divesting itself of a substantial concentration of real estate loans mortgaged and secured by multifamily apartments located in deteriorating and distressed sections of New York City. In so doing, large losses have been incurred which in turn have adversely affected the net worth levels and overall operating performance. Should further substantial losses be incurred, the Association could have difficulty in meeting minimum regulatory net worth levels of the future."

In view of that, was there anything that you people could have done or should have done or wanted to do with regard to the $5 million commitment that they had made in the previous October?

Mr. PUCHALSKY. Well, we addressed ourselves specifically to their writeoff of assets, their sale of mortgages at deep discounts, to have that cash available to invest it in new housing. As a consequence of that method, they did absorb substantial losses.

My understanding of the Association's purpose, one of its purposes, is to help create housing. At that time, the condominium setup in a densely populated area was one of the best approaches to create sufficient housing. The condominium, as I viewed it, and when I viewed it in the records that came to me subsequent to the date of the examination, at that juncture I think it was an approach by the Association which is in accordance with its charter provisions which is to help finance economic housing.

Mr. DRINAN. Therefore, you people, at that moment in time, June 1974, didn't spot any negligence or any overreaching or any mismanagement in the loan to Village Mall?

Mr. PUCHALSKY. I did not, sir, for several reasons. No. 1——

Mr. DRINAN. You spotted no negligence at all. You people went in. You saw this loan of $5 million. You reported this. But you didn't give anyone warning, even the bank, that this might be overreaching?

Now, I'm representing one of the 141 constituents of Congressman Rosenthal. I was just talking to one of them down there who is here or was here. And he blamed it all on the Federal Government and he might blame it on the Congress and he might blame it on one of the Federal executives here. And he said, "When am I going to get my money? My $4,300?"

Now if we want to get a little credibility back to the Government, we have to answer that question. And I suppose it's our function to say, "Well, when is he going to get it back?"

Isn't there some structure within the Federal system to get the money back to 141 people who through the negligence of someone, and we haven't pinpointed the negligence, the point of negligence, but what can wo do for the 141 people?

I'd like the chairman of the board to say something.

Mr. CURRY. Mr. Drinan, I certainly share——

Mr. DRINAN. What have you done for them lately? Have you thought of any special bill, a prior bill going through Congress, a special appropriation, or going to the FDIC, or something, even another loan? Is there any mechanism that could be devised or that might be in existence, by which these 141 people could be made whole?

Mr. CURRY. I think perhaps the best thing that could happen would be that the parties involved can resolve the litigation, and establish responsibility, legal liabilities. It might be possible for the project to go forward somehow and have some recovery.

Mr. DRINAN. We're all lawyers here on this panel. You don't have to tell us that they can go to court. We know that they are in court. They are in the State supreme court and the other bank is there and 141 people. I'm asking you, sir, and this gentleman was blaming you or blaming us. He doesn't know who to blame. He wants his $4,300. There has to be a better way than saying to these poor people, "Well

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go into court and wait your turn." He wants another house. He saved this money over year and years. And what are you going to do for him?

Mr. CURRY. I was not suggesting, sir, that these individuals have to go to court themselves.

Mr. DRINAN. Well they have already.

Mr. CURRY. Well, maybe so. What I was addressing myself to was that if the respective liabilities here, the title company, the Association, the builders, if they can be found, and what are their assets, I wouldn't want to try to practice law here this morning. But the two builders in that situation held those funds in trust. Unless they can establish that the proceeds of those deposits were plowed back into construction of that condominium, they presumably would have the funds. That's one possible avenue.

I was thinking of a more practical, promising situation, that the institution itself and people who bought the condominiums and others may try to come into this project and try to complete it and work something out.

Mr. DRINAN. But, sir, coming back to the gentleman who was here. He asked, "What is this Federal Home Loan Board going to do for me? Can't they give me a loan so I can get my $4,300 back and go out and buy the house of my dreams?"

What are you going to do for him? This week, this month? What can the Congress do?

We're just opening this series of hearings and there are millions upon millions of dollars loaned out for these condominiums by Chase Manhattan and the other banks and we will go into them all. There are thousands of people out there who are like the 141 people in Bayside. So what can the Congress or your agency do for them?

Mr. CURRY. In terms of——

Mr. DRINAN. Instant indemnification I want, he wants.

Mr. CURRY. There's nothing whatever we can do for them in the area——

Mr. DRINAN. Have you even thought of doing something for them, sir?

Mr. CURRY. Yes. I have examined the statutes.

Mr. DRINAN. How about some new statutes?

Mr. CURRY. I will be happy to address myself to that. I definitely think that the Congress, New York State, any authority that can do this, should adopt legislation or adopt policies to be protective of people in this situation.

Mr. DRINAN. Have you recommended this publicly or am I torturing you to get this out of you?

Mr. CURRY. No; I have not recommended this publicly.

Mr. DRINAN. Why not? Why don't you come forward and say, "This is a situation that none of us had foreseen. This bank, rightly or wrongly, with or without negligence, and this agency, with or without negligence, allowed this to happen."

Why haven't you come forward?

Mr. CURRY. The Federal Home Loan Bank Board has made recommendations to the Congress. I think they have made an input into the HUD study respecting the condominium problem. And of course the Board is my superior. I communicate things to this Board and if they buy them——

Mr. DRINAN. Yes, but you never communicated immediate legislation to indemnify 141 people at Bayside, right?

Mr. CURRY. No; I'm not sure that I could make that suggestion at this time in good conscience.

Mr. DRINAN. You wouldn't make it? Would you need some new legislation?

Mr. CURRY. You would certainly need legislation to appropriate the funds to pay these people because I know of no authority that exists in terms of the Federal Home Loan Bank Board or the Federal Home Loan Bank, that would permit us to take funds and pay these people. There's just no authority.

Mr. DRINAN. All right. Coming back to the question of secrecy. It seems to me that you people have the burden of reassuring all of the depositors of the bank in question and the Association, assuring them that you people are doing everything possible or feasible to guarantee their deposits and that they have nothing to worry about. And that you do it in public. You say, let's do it in secret. If I were one of those depositors, I'd say they don't have a plan. And you haven't come up with a plan yet.

We are trying to pinpoint where the negligence was that allowed this horrendous fiasco to occur. I have before me the laws of the United States that govern your particular organization. I want suggestions from you as to where these have to be amended. Why did this happen?

Here is the code that governs the Federal home loan banks. I went through it all last night, chapter 12, section 1420, what happened? Where are the regulations? Mr. Chairman?

Mr. CURRY. I'm not sure I understand your question.

Mr. DRINAN. The question is very simple, sir. Where has the law or the regulations failed so that 141 people in Bayside have the trauma of their financial lives? What happened? It has to be in either the law or the regulations or the administration of it. What can we, this committee of Congress, do to tighten up the law? Answer the question.

Mr. CURRY. I think Chairman Rosenthal has a bill which would preclude the recurrence of what happened to these people. I think there may be other bills pending in Congress.

Now, I don't perceive that those bills would do the Queens residents any good.

Mr. DRINAN. Tell us, sir, in essence, what Mr. Rosenthal's bill does.

Mr. CURRY. If I remember correctly, it would require that deposits put up to purchase property of this nature would have to be held in a trust fund. It could not be used for any purpose. The depositor or the purchaser would get the earnings on his deposit until such time it would disburse to close the loan and he could move into his home.

Mr. DRINAN. Couldn't the Federal home loan bank do that by regulation? I read the powers that you have. They are very broad. Can't you close the door now that the horse has been stolen? Certainly if not by recommendation then by regulation.

Mr. CURRY. I would say that in the case of Federal associations.

Mr. DRINAN. Well, have you done it?

Mr. CURRY. I don't do it, Mr. Drinan.

Mr. DRINAN. But I mean, this is a national problem. It's not just located here.

Mr. CURRY. Yes, I understand. Let me explain. The Board might be able under the statutes they operate under to do this in terms of Federal associations only. But there are many State-chartered associations, there are many commercial banks, there are many people out there making loans, and I think to correct the situation in the future that we must have national legislation on the subject.

Mr. DRINAN. But in the interim, until this bill passes, you are going to tell all banks under your jurisdiction to go ahead even without the recommendations that are forthcoming from this fiasco?

Mr. GOLDBERG. As a result of this and others, we are examining procedures and there may be that we would have some specific regulatory changes that could help, but not solve the problem. But certainly we're not going to just ignore what happened and do nothing. This is a problem of which we are one component. HUD is recommending some major changes. The State of New York has disclosure condominium laws and other States have different types.

I'm certain that this is an area in which we will consider what we can do about any matters, which we deplore.

Mr. DRINAN. For one last question, I come back to the gentleman who spoke to me this morning. He spoke on behalf of 141 others and I don't think, if he is still here, that he gets much satisfaction from this dialog.

Mr. GOLDBERG. There is one other area where we would certainly use our best efforts. If there could be some way found not to litigate but to resolve some of the differences so that the sewer permit could be issued and the title could be performed. We would certainly use our best efforts to work with anyone who would want to finish the project. If we could help in that area we would do everything in our power. And there may be there is an area there——

Mr. DRINAN. He doesn't want to live there anymore. He wants his money back. He will never live there.

Mr. GOLDBERG. I have it in mind that there could be at least an overall settlement package. To the extent that that is feasible, the Board will cooperate in any way possible.

Mr. DRINAN. Thank you.

Mr. BROWN. I think that in the course of our discussion here we have mixed apples with peaches.

With respect to the loan procedure of Washington Federal in this matter, I think it was pretty sloppy, in all honesty. Many things have been mentioned here—the credit report, the way in which some of the procedures were handled. I quite disagree with members at the table who said that all permits, licenses, et cetera, are issued before funds are, before draws are permitted. I think that with any construction project I have ever been associated with, oftentimes there are draws upon acquisition of site and all these things, and I also think that you haven't made it too clear that you, in effect, review each draw and things of that nature upon each subsequent examination, do you not?

Mr. CERRETA. Congressman, not on every loan, no. We only sample loans.

Mr. BROWN. No, I know that but——

Mr. CERRETA. Loans made during the examination period.

Mr. BROWN. Right. But in this case, you would have examined the anticipated activity of the lender as well as completed activity of the

lender. Is that not right? So that you could determine whether they have disbursed funds grossly in excess of the loan devaluation and so on?

Mr. CERRETA. That's right.

Mr. BROWN. So you are always trying to anticipate what will be done and in your examination, looking at the file, trying to determine what they are going to do, whether it complies with regs. And then you are looking at what they have done to see if they did comply. Is that correct?

Mr. CERRETA. That is correct.

Mr. BROWN. You don't in effect examine each act as it occurs?

Mr. CERRETA. That is correct.

Mr. BROWN. All right. Furthermore, don't you as an examiner rely upon the recitations that are made to a lender, to an institution by, for instance, a firm that is authorized to certify completions, et cetera making them eligible for draw?

Mr. CERRETA. That is correct.

Mr. BROWN. Now there is one question, one answer that I was interested in. Do you, in your examination of a loan, take all of the information furnished, for example, by—what was the consulting engineering firm, Harris and something—do you take their statement at face value and never look behind it?

Mr. CERRETA. There is some evaluation of it.

Mr. BROWN. But, by and large, if it is a respectable, reputable professional——

Mr. CERRETA. That is correct. There is further evaluation by the association.

Mr. BROWN. By the association itself. Because the association, of course, has an interest in not having a loan go bad as well as you and the regulatory staff?

Mr. CERRETA. Yes.

Mr. BROWN. You talked about your agency file here. The examination you conduct is at the institution itself, is that not correct? You examine the file that is available in that institution?

Mr. CERRETA. That is correct. And usually we do not take any copies of any of the——

Mr. BROWN. So with respect to supporting documentation, you wouldn't have it in your file?

Mr. CERRETA. I do have some information because I made a special investigation of this loan, in February 1975, and did make some copies of some papers. Otherwise, we would not have them.

Mr. BROWN. Insofar as those deposits that have been made, they were paid directly to the developer?

Mr. CERRETA. Yes; to the builder.

Mr. BROWN. They were never channeled through the institution, as such?

Mr. CERRETA. No.

Mr. BROWN. So the institution had nothing to do with those deposits?

Mr. CERRETA. Not to my knowledge.

Mr. BROWN. There is a New York statute—it was alluded to in Mr. Curry's testimony—what does that statute provide?

Mr. CERRETA. I'm not sure of its exact details.

Mr. PLAPINGER. Mr. Brown, as I recall the New York statute provides that the funds be placed in trust and unless used in connection

with consummation of the transaction, they may not be expended. Is that right?

Mr. GOLDBERG. Yes.

Mr. PLAPINGER. I believe it is section 352h of the General Business Law.

Mr. BROWN. In Mr. Curry's statement, on page 27, he said that questions have arisen as to whether, because of its September 3, 1974 letter, the association became contractually obligated, and so forth. It goes on—

> The association's counsel has denied that there is any such contractural liability, and in doing so has referred to the provisions of the Offering Plan for the VMT project approved by the Office of the Attorney General which noted: "If the purchaser's funds are expended towards the construction of the community and the community is not completed or the offering plan is not consummated for any reason, the purchaser may lose all or part of his down payment."

So there is no requirement under the New York law here?

Mr. CURRY. The requirement is basically a disclosure requirement.

Mr. BROWN. And, in effect, a warning?

Mr. CURRY. A warning. This prospectus has to be approved by law by the attorney general of the State of New York.

Mr. PLAPINGER. There is a statutory requirement, sir, but there is a possibility—and § 352h so provides—that the purchaser may lose his down payment if all or part of it is used in consummation of the transaction.

Mr. BROWN. So, in effect, although New York has spoken in this area, for all intents and purposes, it is the individual depositors involved in this transaction who really get no benefit from that statute.

Mr. PLAPINGER. The indemnification that Mr. Drinan referred to doesn't seem to be in the New York statute, although it contains some safeguards.

Mr. GOLDBERG. As compared with other States, it would appear that in New York if the offering circular plan calls for it, the funds could be used for construction. I think some States more tightly control the use of the escrow funds. I think this is an area where there could be some different legislative philosophies.

Mr. BROWN. This point, I would be remiss for not commending Chairman Rosenthal for bringing the problem to our attention in connection with the passage of the Housing and Community Development Act in 1974. Then you had a rather lengthy amendment as I recall to look into the problem and study the abuses in this area. So we had a bit of redrafting of it but it was incorporated and of course the HUD study has gone on.

I think that recommendations have been made.

Mr. ROSENTHAL. I think Mr. Goldberg that there are some States that have much tougher laws than New York in regards to the holding of deposits in escrow. Ohio has a very tough law. New York doesn't have a tough law. This is a peripheral issue, however.

Mr. CURRY. In terms of the entire country, although you may have, as you usually do, States that have varying degrees of protection and severity, and to accomplish the objective which I suggest ought to be accomplished, Federal legislation is required.

Mr. BROWN. Well, I think that in view of the way in which we have assumed jurisdiction with respect to the interstate land sales, that this

is a similar kind of problem, where there is not the information, and so forth, for protection of residents of the State. We are selling Florida condominiums in Michigan and different places and it probably does lend itself more to a Federal statute. However, there is nothing to stop States from adopting legislation which would preclude or at least place criminal penalties upon this happening.

Really, I have the compassion that Father Drinan has, regarding the deposits that have been lost. There is still a certain amount of caveat emptor about it. I don't think the Federal Government can be a guarantor of every individual's transactions.

In all that, I am critical of the practices which Washington Federal was involved in in this transaction. I don't think the institution itself should be the total faultbearer for the Federal Government for the losses which have been incurred by the individuals. I think it is very unfortunate. I think that steps should be taken to attempt to salvage as much as can be salvaged for those who made deposits. I think that you have indicated that the Board and your institution will do everything that it can to attempt to achieve some kind of a recompense.

Mr. ROSENTHAL. Mr. Mezvinsky?

Mr. MEZVINSKY. I will be brief.

I think what is clear, Mr. Curry, is that first of all it is a bad loan. But what I think is more disturbing is how you check a bad loan.

I am also concerned about guidelines for financial statements and appraisals that are intentionally made high in order to obtain a loan.

What kind of check is there on credit financial transactions? How do you prevent disbursements to the developer, where he puts the money into a second project, resulting in the first project going down the drain? In this case, 141 investors are holding the bag to the tune of $600,000.

I think that it is your responsibility to take a look at this situation and learn a lesson from it. These problems are so obvious that we all, I think, agree that they have to be corrected.

In view of all that has been laid on the table today, all the examples about the permit, about the appraisal, about financial statements, about disbursements, what can you do to insure that it doesn't happen again? To tighten up the procedures?

As an aside, I would also recommend not expanding Washington Federal's activities into branch operations until they clean up their own house.

Mr. CURRY. Well, right at this moment, sir, I would think that one of the benefits of this hearing and one of the benefits of our investigation of this particular situation will be to produce some different regulations and different policies.

But as of this particular moment to come up and say what those recommendations might be, I think I would rather have time to reflect on the record of this hearing, the record of this institution. Also I am in the posture of having to make those recommendations to the Federal Home Loan Bank Board.

I feel reasonably certain they will be looked into most carefully.

Mr. MEZVINSKY. The significance, I hope, of the hearing is to show that we have looked at only one example. I don't think it is unique. I think the problem is deep. You don't have to be in New York to see it. I think it is absolutely essential that we make some recommenda-

tions and find some means of indemnification and protection for those that have suffered.

Mr. Chairman, I would conclude my questioning and commend you for bringing this to the attention of not only the people of New York but the people of this country.

Mr. ROSENTHAL. We are going to conclude the hearing now.

We are not going to accept your offer of going into executive session. I think that would be inappropriate for either us or you. The matter of the dignity of this association ought to remain in public and the integrity of the association ought to remain in public. I don't think it would be useful for anybody if we examined Washington Federal in an in-camera session.

I do think this, that you and your associates must bear a significant share of the blame and responsibility for what happened here. That may be difficult to accept personally. But I talk of it institutionally.

There are at least a half dozen or more ways that this loan and the practices by this institution violated your own specific and unwritten regulations and rules. The credit investigation was handled in an inappropriate manner for this kind of a loan; the acceptance of the unaudited statements was inappropriate; and the entire investigation and inquiry of a $5 million loan was amateurish.

Disbursing funds without obtaining all necessary permits is absolutely irrational, if not negligible. To this day there still isn't a sewer permit and yet over $2,600,000 has been disbursed. To allow this developer to remove equity capital from the VMT project and to comingle funds with another project, is irresponsible.

The point that I am trying to make, Mr. Curry, was that if you had been doing a vigorous investigative job regularly then you would have spotted these irresponsible practices. Your defense is that you didn't examine Washington Federal until 1974, after the commitment had been made. If you had been doing your job on a regular basis, Washington Federal, which was in trouble, would not have been permitted to make this kind of loan. You would have stopped it before the commitment had been made. You would have stopped it before the money had been disbursed. You would have stopped it before these people lost $600,000.

In terms of responsibility, you are responsible, institutionally, Washington Federal Savings and Loan is the principal source of responsibility, because these purchasers, even though the offering was approved by the Attorney General with that caveat emptor, they went into this deal because they knew a bank insured by the U.S. Government had made a loan on the VMT property.

They relied on the fact that the project was being financed by a federally chartered and insured association. If they hadn't seen that support, you can be sure they wouldn't have invested in VMT so readily. You know if there had been a big sign on the property that said "Money Loaned by the Mafia" or "Money Loaned by Bebe Rebozo" or "Money Loaned by Howard Hughes" they would have walked away from this project.

Money loaned by an institution insured by the U.S. Government gives it a stamp of credibility, stamp of integrity. The bank was irresponsible in the way they handled this loan. You and your examiners,

I feel, personally, did not do the kind of job that we have mandated you to do.

I think you have to look at your own house and do a little housecleaning so that you could do a better job, and avoid another occurrence such as VMT.

We all have to look at what we can do to rectify this situation so that these people are not out $600,000. Whether that should come from you, from your resources, the bank resources, of the Federal bank insurance, I have no idea.

In my judgment, these people are innocent. We collectively are responsible.

Mr. BROWN. We have all consistently spoken to Mr. Curry as being the one responsible. Of course, he is representing the Federal Home Loan Bank Board here which is the examining and regulatory body. His official position is president of the New York bank. It does not mean that he is in any way responsible as a part of the institution, the savings institution.

Mr. ROSENTHAL. I am also distressed if not disturbed by the fact that two former associates of the board now serve as president and chairman of the board of Washington Federal. I don't know if Washington Federal got favorable examination treatment from the board. I assume they didn't, very frankly. But it raises questions as to the thoroughness of the exam. I am not happy with the fact that three directors of this bank obtained $60,000 mortgages at preferential rates. It raises questions as to their conduct in office. Those kind of practices must be stopped. We cannot afford to have them continue.

Mr. MEZVINSKY. Mr. Chairman, in view of what else has come out today, I think we have a significant policy question as to potential conflict of interest of those serving on these boards that will handle associations and banks. I think that is a question that the public is obviously going to ask as a result of this example.

Mr. DRINAN. Just one last point, Mr. Chairman. The rules of the group here with regard to absentee bankers is very, very lax. Originally, a person must have professional or residential interest, that is not retroactive, and as the gentlemen said to me, one of the 141 that got cheated, he said there are a lot of absentee bankers who have no connection with the area that I live in, who have taken this money. I think the laws and regulations on that need to be updated. Thank you.

[Mr. Curry's prepared statement follows:]

PREPARED STATEMENT OF BRYCE CURRY, PRESIDENT, FEDERAL HOME LOAN BANK OF NEW YORK

The Federal Home Loan Bank Board (Board) appreciates the opportunity to present its views respecting the Board's role and philosophy in chartering Federal savings and loan associations and approving branches for such associations, and in examining, supervising and regulating Federal savings and loan associations and State-chartered savings and loan associations insured by the Federal Savings and Loan Insurance Corporation (FSLIC). This Statement also responds to certain questions of the Subcommittee respecting Washington Federal Savings and Loan Association, New York, New York (Washington Federal).

The Board is the Federal chartering, examining and regulatory authority for Federal savings and loan associations. The Board also is the operating head of the FSLIC -- a governmental agency which, among other things, insures the savings accounts of all Federal associations and those State savings and loan associations which qualify for FSLIC account insurance. The Board also directs the operations of the Federal Home Loan Bank System, which includes the twelve regional Federal Home Loan Banks whose responsibilities include, among other things, making credit advances to their member thrift institutions. The Presidents of the twelve Federal Home Loan Banks, and other officials of the Banks designated by the Board, also act as Supervisory Agents for the Board and the FSLIC respecting supervisory and related matters.

The foregoing responsibilities of the Board, and the authority exercised in connection therewith, emanate from three statutes: The Home Owners' Loan Act of 1933, the National Housing Act, and the Federal Home Loan Bank Act. The Home Owners' Loan Act provides the Board with a broad range of powers over Federally-chartered savings and loan associations while the National Housing Act and the Federal Home Loan Bank Act provide the Board with supervisory authority over State-chartered savings and loan associations.

An Overview of the Board's Chartering, Examining and Regulatory Philosophy and Role

The Board's chartering objective is basically to provide aggressive, dynamic and profitable thrift institutions which do an effective job of servicing the needs of savings and home-borrowing consumers.

Section 5(e) of the Home Owners' Loan Act, 12 U.S.C. 1464(e), provides that no charter may be issued for a new Federal association unless the Board finds that the applicant group consists of persons of good character and responsibility, and that a necessity exists for the new association in the community to be served, that there is a reasonable probability of the new association's usefulness and success and that the proposed Federal association can be established without causing undue injury to properly conducted existing local thrift and home-financing institutions.

The Board requires comprehensive written submissions by the charter applicant group to substantiate that the above-mentioned criteria have been satisfied. Particular focus is made upon the first test -- the character and responsibility of management, and a confidential biographical and financial report is required of each member of the applicant group, prospective director and managing officer.

With respect to the composition of the organizing group (that is the applicants and prospective directors), the directorate must consist of at least seven members, and at least a majority of the directors must have both their residences and their business or professional interests in the community to be served, with the remainder having one or the other. In addition, the directorate should be reasonably well-balanced and composed of citizens representative of the diversified interest of the general area in which the association is located, with not more than one-third of the directors in businesses which are closely related to the savings and loan business.

In other words, any type of business in which the owners would stand to profit substantially from the financing and lending activities of the association would be generally classified as being engaged in a closely related business, e.g. construction; land ownership and development; building materials and supplies, real estate sales; real estate finance and investment; mortgage insurance; mortgage brokerage; title insurance; casualty, fire

and life insurance; escrow companies; loan origination and closure and appraisal, etc.

Great care must be taken in the initial screening of the management group at the charter application stage since, under the existing statute, an officer or director of an FSLIC-insured institution cannot be removed from office by the Board unless he is found guilty of a violation of law or regulation, unsafe or unsound practice or breach of fiduciary duty which -- (1) causes or is likely to cause substantial financial loss or other damage to the association or serious prejudice to the interest of the savers of the association, and (2) involves personal dishonesty on the part of the director or officer. Under existing law, an officer or director cannot be removed for gross negligence or willful disregard of safe or unsound operating practices. However, in October 1975, the Board submitted proposed legislation to the House Committee on Banking, Currency and Housing, which would extend the substantive grounds for suspension or removal to include violations, practices or breaches of fiduciary duty which demonstrate the officer's or director's gross negligence in the operation or management of the institution or a willful disregard for the safety or soundness of the institution.

As with certain other applications, applications for permission to organize a Federal association are subject to protest by competing financial institutions. If a

substantial protest is filed, an oral argument on the application is held before the Board's Supervisory Agent at which the interested parties may appear. The Board, in passing upon the application, considers the application and supporting material, the written protest submissions and the transcript of the oral argument. During 1975, the Board approved six applications for permission to organize a Federal association, and disapproved eight such applications. Certain of the disapprovals were based -- at least in part -- upon the Board's concern that the proposed management of the new Federal association was engaged in businesses too closely related to the savings and loan business.

Under the Board's governing regulation, a branch may be established by a Federal association if it demonstrates that there will be at the time the branch is opened a necessity for the proposed branch office in the community to be served by it, that there is a reasonable probability of the usefulness and success of the proposed branch office, and that the proposed branch can be established without undue injury to properly conducted existing local thrift and home-financing institutions. In addition, the Board's branching regulation, 12 CFR 545.14(f), provides that "no application for permission to establish a branch office shall be approved if, in the opinion of the Board, the policies, condition or operation of the applicant association afford a basis of supervisory objection to the application." This means that the Board will not approve

branch applications of Federal associations with major and serious supervisory problems which management appears unable or unwilling to correct, or with substantial financial difficulties unless such difficulties are of a nature which could be remedied by additional savings flows and mortgage lending likely to be generated by the proposed branch office. In addition, the Board takes supervisory objection to a branch application where it appears that the applicant lacks the requisite managerial resources to successfully staff and operate additional branch facilities.

The Board's role as the regulator of insured savings and loan associations is one of fashioning and implementing a comprehensive regulatory scheme necessary to guide such institutions in their dual functions of providing a safe depository for the public's savings capital and providing adequate funds to meet the nation's housing needs. Concomitantly, the Board, through its Office of Examinations and Supervision (OES) and the Supervisory Agents at the regional Federal Home Loan Banks, determines the extent of adherence to the regulations and to safe and sound operations, and obtains appropriate corrective actions when deviations are detected.

The Board's philosophy of regulation is a simple and basic one. We believe that those regulations and policy guidelines should be promulgated and enforced that are necessary to assure that statutory demands and intent are

met; that prudent, safe and sound operations are the desired end result of regulatory activities; and that regulatory control should not go so far as to improperly and unnecessarily restrict basic free enterprise. The Board recognizes that there are limits on its regulatory authority, and that the association's management -- not the Board --is responsible for making the business decisions of the institution. Within those broad parameters, the Board believes it is charged with taking required affirmative actions. These may be categorized as guidance (the establishment of regulations that are in the public interest), monitoring and fact-finding (the examination process), and correction of abuses (the supervisory process, both preventive and remedial).

The Board has established through its regulations various restrictions and limitations which must be observed by each insured institution. For example, our regulations set forth criteria for the types of loans which can be granted and prescribe various underwriting safeguards and controls which must be utilized. Our authority over Federally-chartered associations is, of course, more extensive than that exercised over State-chartered institutions. New laws and programs have required additional regulations to establish guidelines for the industry to follow.

The Board considers the examination process to be essentially a continuous one. We monitor the activities and operating results of insured institutions.

Periodically, examiners of the OES staff make in-depth specific reviews of the business and affairs of the institutions. The product of these on-site reviews is the examination report which serves as the basis for initiating supervisory action.

The frequency of the on-site examinations is reflected in the following table. These data relate to both Federally-chartered and State-chartered insured associations.

F/Y Year End	Total No. of Insured Associations	Total No. of Examinations Commenced	Average No. of Months Between Examinations
		NATIONALLY	
1975	4,110	3,569	14.4
1974	4,152	3,177	15.1
1973	4,168	3,176	16.1
		SECOND DISTRICT (FHLBank of New York)	
1975	344	318	12.76
1974	362	322	12.98
1973	370	332	13.78

The Subcommittee may be interested in knowing how the frequency of examinations of Washington Federal compare with the National and Second District averages. During the last six years the association was examined commencing on the following dates:

March 9, 1970	June 22, 1973
January 13, 1971	June 26, 1974
October 12, 1971	April 15, 1975
July 28, 1972	

A new examination of the association commenced as of January 7, 1976, and it still is in progress.

The scope and depth of the examination process are variable. There is a prescribed minimum scope which emphasizes strongly the lending policies and procedures, savings activity, asset management, financial management, managerial and financial resources, and compliance with various specific statutes and regulations. This review is done on all examinations. Where problems are detected both the breadth and depth of the review are extended to the degree necessary to ascertain all necessary and pertinent facts. Ordinarily, the examination report discloses those aspects of the association's operations which may be indicative of adverse trends, unsafe or unsound practices, violations of law or regulations and other matters of supervisory concern. The association's lending policies and practices are scrutinized as well as any imbalance in its loan portfolio. Concentrations in certain types of loans, properties, borrowers or locations are reviewed and analyzed in determining adverse effects which may devolve from such loan concentrations. Scrutiny is given to speculative loans, and to loans beyond the regular lending area, statewide or nationwide, and determinations are made with respect to such loans conforming to various regulatory restrictions placed on such lending by the supervisory authorities.

The examination process can utilize up to 32 examination programs and 26 control and general questionnaires. These programs set forth the objectives and procedures necessary to complete each phase of the examination. They provide a flexible but essentially standardized process, quality control, and a documented record of the work performed.

A fundamental and overriding element in the Board's philosophy of examination and regulation is the concept of "preventive supervision." This term is used to cover our system of monitoring, examinations, analysis, and early supervisory action designed to identify and correct potential or incipient operating weaknesses before they create material problems. For this purpose, the examination activity emphasizes the review of policies and procedures to determine whether they are designed to achieve proper results.

However, should an institution pursue policies and procedures which violate our governing statutes and regulations or which otherwise constitute unsafe and unsound practices, we initiate remedial supervisory action to obtain correction. Generally, the supervisory letter from the Supervisory Agent pointing out such violations and practices is sufficient. However, in some cases the Supervisory Agent must conduct a meeting with the directorate and management to get an adequate response. In those cases where the institution is recalcitrant, the agency may apply progressively stronger measures up to and including the institution of a Cease-and-Desist action, and the enforcement of a Cease-and-Desist Order (issued by the Board after an APA hearing) in the courts. The level of supervisory action taken depends, of course, on the receptiveness and cooperation of the institution involved and the nature of the supervisory problem.

Where the supervisory problem relates to a particular member of management, the Board -- after an APA hearing -- may remove the offending member if it finds that the statutory criteria for removal, discussed earlier, are satisfied. Termination of insurance and termination of FHLBank membership are rarely used statutory remedies which, as a practical matter, are available in only an extraordinary case in which the violations are beyond correction by any other means, including Cease-and-Desist proceedings.

The Board's Supervisory Control System

While the overwhelming majority of the FSLIC-insured institutions are operated in a satisfactory manner, there are institutions which are currently of substantial supervisory concern to the Board. These are the institutions which receive either a "3" or "4" examination category rating.

OES assigns a composite rating to each institution at the time the examination is completed. These ratings are:

"1" - An institution so rated would be free of adverse comment relating to matters of substance and would give no cause for supervisory concern.

"2" - An institution so rated does not measure up in important respects to the elements of a "1" rating, but the nature or severity of any problem is not considered material in assessing the overall soundness or stability of the institution.

"3" - An institution with this rating has one or more material problems of either a temporary or continuing nature requiring close examining and supervisory attention and constant pressure for correction.

"4" - This rating is reserved for those institutions with (1) major and serious problems which management appears to be unable and unwilling to correct or (2) problems which pose a threat to its continued corporate existence. In these cases, the problems may not be insoluble, but the situation is of such large dimensions and so critical that urgent corrective action by the directorate or the Board appears necessary.

The composite rating is assigned after reviewing nine factors. These are:

1. Management and Organizational Structure - 9 elements
2. Lending Policies and Practices - 12 elements
3. Financial Management - 4 elements
4. Compliance with Laws and Regulations
5. Records, Systems, and Controls
6. Operating Results - 3 elements
7. Net Worth - 2 elements
8. Scheduled Items and Substandard Assets - 4 elements
9. Wholly-Owned Service Corporations - 6 elements

When a "3" or "4" composite rating is assigned, the institution comes under surveillance in our Supervisory Control System (according to the seriousness of a specific factor, a "2" rated association is occasionally included). This means that the Supervisory Agent in most instances must promptly meet with the association's board of directors, inform them of our concerns, and (assuming that we believe the requisite statutory grounds exist) explain that formal proceedings leading to a Cease-and-Desist Order will be initiated if compliance is not prompt.

A follow-up examination is then scheduled to determine whether the directed compliance has been made. If it has, the institution will receive a satisfactory rating and will be dropped from the Control System. If compliance has not been achieved, the institution will remain in the Control System, and formal proceedings will be initiated, provided the requisite statutory grounds exist. In this way, all associations that have one or more material problems are placed and kept under close scrutiny.

There is a further level of categorization. Those institutions that represent problems that are overriding and material are placed in the Board's Problem Book. Within that book they are shown either in Category I - Financially Critical (those whose financial condition is such as to ultimately threaten to involve the FSLIC in a financial outlay unless drastic change can be brought about), or Category II - Not Financially Critical (those where there is a lesser degree of vulnerability but which give cause for more than ordinary concern and require aggressive supervisory control). Washington Federal's problems are not of a materiality or severity as to warrant inclusion in the Problem Book, and the association has not been included in the Problem Book.

Study and evaluation of the Board's Supervisory Control System -- and the examination and preventive supervision processes which relate to such system -- is an ongoing process. We believe that our system has worked reasonably well over the years. One reason for this is that we continually seek

to improve the system in order to keep it responsive to developing problems.

The Safety and Growth of FSLIC-Insured Institutions

Since 1940 there have been only six failures of FSLIC-insured savings and loan associations. In each instance, the liquidation of the association in receivership has produced, or is expected to produce, sufficient funds to pay in full the principal amount of the claims of savers whose deposits exceeded the maximum amount of FSLIC insurance coverage; moreover, in four of these S&L receiverships there is or will be a surplus available to pay interest on savings account claims. In other cases, the Board has avoided any loss to savers by assisting in voluntary liquidations, negotiating supervisory mergers, and providing financial assistance to avoid default. Savers have not lost a single penny deposited in accounts insured by the FSLIC.

Moreover, although the final results are not in, it appears that the savings and loan industry has weathered the recent recession far better than have most types of financial institutions.

The above-mentioned record of safety, in the Board's view, is noteworthy, particularly in light of the fact that FSLIC-insured institutions have grown from $6.1 billion in assets at the end of World War II to nearly $329 billion in assets as of November 30, 1975, and have become the major source of residential mortgage funds in the United States. We believe that this record of safety and growth is a direct result of the Board's regulatory philosophy discussed earlier.

Consequence of Failure to Meet Minimum Net Worth and FIR Requirements

The net worth of a savings and loan association consists primarily of earnings received in profitable years to provide a cushion to absorb losses which occur on its investments or operating losses in subsequent unprofitable periods. In associations issuing permanent stock, the stock also is considered a part of net worth.

In most associations the largest component of net worth is the Federal Insurance Reserve (FIR) which generally must be maintained at a level of 5% of savings for an institution insured 20 years or more. The FIR may only be used to absorb investment losses. The other general component of net worth is undivided profits or surplus which has been set aside for other corporate purposes, such as operating losses.

Board regulations require that total net worth be maintained at certain levels above that for the FIR as may be determined based on delinquent loans, foreclosed real estate, and other high risk investments. The additional amounts are specified in rather detailed and comprehensive regulations.

Compliance with FIR and net worth requirements is determined once a year as of an insured institution's annual closing date. Once the dollar amount of such requirements is determined, the association must maintain its FIR and net worth accounts at least in such amounts until the next

annual closing date. Those associations which fail to meet or thereafter maintain the FIR and/or net worth requirements may be required by the Board to take corrective actions. The corrective actions initially are sought on a voluntary basis, but if they are not thus obtainable, compliance may be obtained through the institution of enforcement actions, such as Cease-and-Desist proceedings.

The remedial restrictions, conditions and/or sanctions imposed upon the institution are related to the cause of failure to meet or maintain FIR and net worth requirements and are directed toward: (1) bringing the institution into prompt compliance; (2) precluding a recurrence of the failure; and (3) preventing any further aggravation of the existing failure. Any area of an association's operations which contributes to the failure is subject to restrictive and affirmative conditions. Should an insured asssociation refuse to enter into a supervisory agreement, the Board may seek to impose such corrective actions through enforcement proceedings.

The types of corrective actions which are most commonly required by the Board and its staff are:

1. Discontinuance of types of lending which have caused losses;

2. Improvement of loan underwriting procedures;

3. Curtailment of growth pending the strengthening of net worth;

4. Reduction of expenses; and

5. Strengthening of management resources.

The FHLBanks' Lending Practices to Associations to Permit them to Meet Reserve Requirements

Federal Home Loan Bank advances are not granted to member savings and loan associations for the purpose of enabling them to establish or maintain the minimum level Federal insurance reserve requirements. The Federal Home Loan Bank Act (12 U.S.C. 1421, et seq.) contains statutory authority for each Federal Home Loan Bank to make advances to its members upon the security of home mortgages, or obligations of the United States, or obligations fully guaranteed by the United States, subject to such regulations as the Board prescribes. Thus, access by members to advances is a privilege which may be limited.

Advances to members are made to enable them to meet savings withdrawals or liquidity requirements, and to make mortgage loans. In making advances to help expand mortgage investments, the Banks are required to consider the soundness of credit, the need to stabilize home financing, the discouragement of building booms, and prevention of distressed conditions in the housing and mortgage markets.

The soundness of the borrowing institution is always a major consideration in granting advances. Members having lending experiences which indicate less than satisfactory credit practices, lower than desirable reserve levels or additions to reserves, high expense ratios, or other relevant characteristics creating a less than satisfactory posture, are by Board policy (12 CFR 531.1) either limited in or denied the use of advances for expansion.

Soundness of Washington Federal's Lending and Disbursement Practices Respecting Real Estate Construction and Development Loans

During the period between March 9, 1970, and April 15, 1975, Washington Federal made or purchased approximately 7,300 mortgage loans aggregating $329,000,000. Included in these totals are 44 loans for $98,694,140 which were for land acquisition and development or for construction of other than one-to-four family dwellings. In addition, the association made, purchased or refinanced, 86 loans secured by multi-family (over four family) dwellings, and commercial and specialty-type properties. These aggregate $57,248,153. Construction loans shown above include FHA loans totaling $9,233,440 to insure Rehab programs.

The Board's regulations place limitations on various types of real estate loan investments. Our examiners have not reported any instances where this investment authority was exceeded by Washington Federal. They did note that the association moved into the area of construction and specialty lending in 1970-71, and that this form of lending does carry a higher risk factor than does the traditional single-family dwelling loan.

Under the association's policies and procedures, the total of each construction loan, and the total of disbursements on that loan at any stage of construction, are limited to a percentage of the total value of the property. This percentage is dependent upon the type of security property

and the terms of the loan. The property is appraised by two independent appraisers as a condition for making the loan.

Of the 130 large construction or development loans made or purchased by the association, only five were classified as substandard and listed as of April 30, 1975, as "slow" loans because of delinquencies. One, a nursing home, was classified as substandard because the home has not been completed (the loan, however, is not delinquent). Three of the loans were land loans made in 1973 and 1974. All five loans were reviewed by examiners during the examination subsequent to their being made and no supervisory criticism was the association's lending and disbursement practices was made.

Washington Federal's
Loans to Doctor Bergman

The Subcommittee has inquired as to two loans made by Washington Federal to the Targee Care Center and the Cambridge Care Center. Doctor Bernard Bergman is the principal of both companies.

The Targee loan was made on March 24, 1970. The loan originally was made for $1,725,000 (with $1,380,000 available for construction); the amount of the loan subsequently was increased to $2,225,000 on March 17, 1972. The construction loan was for 12 months with interest at the rate of 11 percent per annum (only interest on the loan was to be paid during construction). The permanent loan was to be for a term of

25 years, with monthly amortization, and with interest at the rate of 9 percent per annum. The loan was supported by two independent appraisals, one in the amount of $2,375,000 and the other in the amount of $2,380,000 (on February 28, 1972 and March 6, 1972, two revised appraisals in the amount of $3,250,000 were submitted).

Washington Federal received a $34,500 commitment fee for the Targee loan. Appraisal fees of $8,300 were paid, together with an engineer fee of $4,312, in connection with this loan.

The security property for the Targee loan is a 240 bed nursing home facility located on Staten Island, New York. The home is approximately 94 percent completed, and is unoccupied. The construction loan was never fully disbursed, with $76,000 remaining in loans in process. In addition, the $845,000 available for disbursement upon conversion to permanent loan status also has never been disbursed. Despite this, amortization payments have been made since July 1972, and the loan is paid through December 31, 1975. The loan balance, net of the $921,000 still to be disbursed, is $950,639.

A certificate of occupancy has not been obtained for the nursing home. The facility was originally approved as a nursing home. The principals subsequently applied for permission to switch the use to a mental retardation facility, but yielded to community opposition and re-applied for a license to operate as a nursing home.

The Cambridge loan was made on October 1, 1969, in the amount of $1,750,000 (with $1,380,000 disbursement for construction). The construction loan was for 12 months with interest at the rate of 8 percent per annum (only interest on the loan was to be paid during construction). The permanent loan was for a term of 25 years on a direct amortization basis with interest at the rate of 7-1/2 percent per annum. The loan was supported by two independent appraisals in the amount of $2,300,000.

Washington Federal received a $13,800 commitment fee for the Cambridge construction loan; appraisal fees of $4,000, an engineer fee of $3,450 and a legal fee of $2,000 were paid in connection with the construction loan. Washington Federal also received a commitment fee of $17,250 for the Cambridge permanent loan, and a legal fee of $1,635 was paid in connection with such loan.

The security property for the Cambridge loan is a 240 bed nursing home located in the Bronx, New York. The association also has Doctor Bergman's personal guaranty on such loan.

The Cambridge loan is paid through December 31, 1975; the current balance on the loan is $1,630,150.

Applications for the Targee and Cambridge loans were submitted to the association's Mortgage Committee, along with appraisals made by two independent appraisers, and credit and financial information. Credit analysis was made by the association's Credit Department. Upon approval of the

loans by the Mortgage Committee, commitment letters were issued. Disbursements were based upon inspections made by the consulting construction engineers, and upon a continuation of title search before each advance.

The Cambridge loan was reviewed during the March 9, 1970, examination of Washington Federal by Board examiners, and the Targee loan was reviewed during the January 13, 1971, examination of the association. In both instances, no supervisory exceptions respecting the loans were taken. These loans were in conformity with the Board's regulations, and were in accordance with safe and sound lending practices. These two loans are not now -- and have never been -- in default.

The Village Mall
Townhouse, Inc.
(VMT) Loan

The Issuance of the Loan

Washington Federal granted an 18-month construction loan on October 30, 1973, to VMT in the amount of $5,000,000, at an interest rate of 2-1/2 percent over the prime rate of the Chemical Bank, adjusted monthly. A 60 percent participation in the loan subsequently was sold by the association to Bankers Trust Company on January 14, 1974.

Principals of VMT are Lawrence Rosano and Michael Newmark. To the best of our knowledge, the association has had no other dealings with these builders. A check of the association's records disclosed no apparent interest of Washington Federal's personnel in the loan or the project.

The security property, when completed, would consist of four individual three-story elevated buildings located at 26 Avenue and Corporal Kennedy Street, Bayside, New York. Thirty-three condominium units were planned for three of the buildings and forty-two in the fourth building, a total of 141 units.

The association had also undertaken to make individual permanent loans to condominium purchasers for up to a total of $6,000,000. Approximately 120 units were sold in the first week of the offering, and 109 commitments for mortgages were issued by the association.

In making the VMT loan, Washington Federal received credit reports from Retailers Commercial Agency, Inc. and Dun and Bradstreet, Inc., which were supplemented by financial statements of Messrs. Rosano and Newmark. In addition, Washington Federal's records reflect that Security National Bank commented favorably on its dealings with VMT principals. In addition, in making such loan appraisals from two firms were obtained: one dated March 15, 1973 setting a final value of $7,000,000 of which $1,700,000 was for land; another dated April 2, 1973 setting the final value at $6,750,500, with $1,762,500 allocated to land.

Washington Federal received a $170,000 commitment fee for the VMT loan; in addition, appraisal fees of $12,000, an engineer fee of $9,500, and a legal fee of $7,500 were paid in connection with this loan.

A firm of construction consultants was employed by the association to review the plans and specifications for the project and to act as supervisory architectural engineers. On September 12, 1973, the firm advised the association that construction costs of $4,189,991 would be sufficient to complete construction. On November 15, 1973, a revised direct construction cost figure of $4,150,000 was deemed sufficient to complete construction.

The title report issued in connection with the VMT loan contained an exception with regard to a sewer easement which provided for a sewer line to an adjoining project which had not yet been installed. No funds were to be advanced for building No. 3, which was to be constructed over the easement area, until this matter was resolved and the exception removed.

The June 26, 1974 Examination of Washington Federal

A review of the loan was made by Board examiners at its June 26, 1974 examination of the association. At that time, a total of $2,270,000 had been disbursed, supported by a May 30, 1974 status report by the firm of construction consultants, which indicated the construction to be approximately 33 percent complete. Based on $4,150,000 allocated

to direct construction costs, the consulting firm had approved $1,370,000 in advances. That latter sum, plus $850,000 disbursed on the value of the land and a $50,000 disbursement for stored materials, totaled $2,270,000. These are gross figures and Washington Federal, as noted above, had only a 40 percent participation interest in the loan.

In estimating the percentage of completion, the construction consultants did not include the work completed on building No. 3. This was based on association instructions since approval for a sewer system had not been obtained. The builders had agreed that they would not request any funds for work done on this building and that no construction would be done over the easement area until the sewer system problem had been resolved.

The examiners completed FHLBB Form 914, "Review of Major Loans" and, based on their analysis of the loan, made no supervisory objection. Based on the progress reports submitted by the construction consultants and the examiner's review of the document file, no inspection of the VMT project or further comment on the VMT loan was indicated.

Progress of Construction

In a progress report dated March 8, 1974, the construction consultants raised questions on the failure of the developer to obtain final approval from the Building Department for the storm and sewer system, and recommended

that all advances be suspended pending clarification of this situation. The consultants apparently received assurances that final approval would be forthcoming, and approved subsequent advances although not on building No. 3.

An inspection on July 29, 1974 indicated construction work, excluding work on building No. 3, was approximately 42 percent completed, and on that basis, the total amount of approved advances for construction was $1,764,000. The construction consultants submitted a progress report of the project as of August 29, 1974 showing construction to be 51 percent completed, including work completed on building No. 3. Thereafter no further funds were disbursed.

Subsequent Developments

When work was halted in August 1974 on the VMT project, many of the purchasers who had made downpayments (of up to $7,300) on project condominium units, aggregating some $568,000, became concerned about the safety of their downpayments. The New York State Attorney General was asked to investigate.

The builder-principals, Newmark and Rosano, asked the association to advance $50,000 for work done on project building No. 3, to be used to make partial refunds to purchasers. Based on the amount of work completed on building No. 3, an additional $352,500 could have been disbursed by the association, but was withheld pending satisfactory settlement of the sewer situation. The association

apparently agreed to the disbursement. A letter dated September 3, 1974, from the association to the builder indicated the association's willingness to disburse the $50,00 for refund purposes and, subject to resolution of the sewer problems, an additional $302,000 also would be made available for refund purposes. These funds were not advanced because a title search disclosed mechanics' liens of some $2 million and a second mortgage on the property of $41 million.

Questions have arisen as to whether -- because of its September 3, 1974 letter -- the association became contractually obligated to the purchasers for the downpayments. The association's counsel has denied that there is any such contractual liability, and in doing so has referred to the provisions of the Offering Plan for the VMT project approved by the Office of the Attorney General which noted: "IF THE PURCHASER'S FUNDS ARE EXPENDED TOWARDS THE CONSTRUCTION OF THE COMMUNITY AND THE COMMUNITY IS NOT COMPLETED OR THE OFFERING PLAN IS NOT CONSUMMATED FOR ANY REASON, THE PURCHASER MAY LOSE ALL OR PART OF HIS DOWN PAYMENT."

On October 21, 1974, the association instituted foreclosure procedings because of the builder's failure to make payments due September 1 and October 1, 1974.

We understand that on April 25, 1975, the association was advised of a defect in title because VMT apparently did not own the property at the time the loan was closed. Apparently, the principals owned the property in a partnership name and, prior to the loan closing, had not transferred the property to the corporation. Because of the title defect, parties who filed mechanics' liens have asserted claims purportedly superior to that of the association, as have the purchasers of condominium units. In addition, Bankers Trust Company has sued the association for return of all money it advanced on the loan.

To date, attempts to settle the various claims so that the project may proceed have been unsuccessful.

For the above reasons, the foreclosure action has been delayed. It is our understanding that the association cannot obtain a judgment until the title defects and claims priorities matters are resolved.

As of December 31, 1975, the loan was delinquent 16 months. In addition to the amount disbursed for construction, the association has advanced $64,896 for foreclosure and other fees. Of the total amount disbursed, $2,614,000, the association's participation was $1,110,496, as of that date.

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We hope that the aforegoing information will be useful to the Subcommittee. The Subcommittee can be assured of the Board's continuing cooperation and assistance, and representatives of the Board will respond to the Subcommittee's questions respecting the above matters.

Mr. ROSENTHAL. The subcommittee stands adjourned, subject to the call of the Chair.

[Whereupon, at 1:15 p.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

OVERSIGHT HEARINGS INTO THE EFFECTIVENESS OF FEDERAL BANK REGULATION

(Federal Home Loan Bank Board's Supervision of Washington Federal Savings & Loan Association)

THURSDAY, MARCH 11, 1976

HOUSE OF REPRESENTATIVES,
COMMERCE, CONSUMER,
AND MONETARY AFFAIRS SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:45 a.m., in room 2247, Rayburn House Office Building, Hon. Benjamin S. Rosenthal (chairman of the subcommittee) presiding.

Present: Representatives Benjamin S. Rosenthal, Garry Brown, Willis D. Gradison Jr., and John N. Erlenborn.

Also present: Ronald A. Klempner, counsel; Eleanor M. Vanyo, assistant clerk; and Henry C. Ruempler, minority professional staff, Committee on Government Operations.

Mr. ROSENTHAL. The subcommittee will be in order.

This morning's hearing continues this subcommittee's ongoing investigation into the effectiveness of the regulatory and supervisory practices and procedures of the Federal bank regulatory agencies. Today's hearing is our second one into the affairs of Washington Federal Savings & Loan Association of New York, which primarily serves upper Manhattan and the Bronx and other areas of New York State. One of the loans we are concerned with was a $5 million construction loan made by Washington Federal in 1973 for a 141-unit luxury condominium development in Bayside, Queens, known as Village Mall Townhouses. The Village Mall project was only half completed when construction halted and the loan went into default in September 1974. Over $600,000 in downpayments from individual unit purchasers has not been returned.

Despite the Federal Home Loan Bank Board's failure to criticize this loan in four separate examinations, there is evidence that it was ill-conceived and poorly administered. For example, the subcommittee has learned that Washington Federal Savings and Loan relied on an inadequate $5 credit report for the $5 million loan; that Washington Federal Savings and Loan disbursed over $2.6 million for the Village Mall Townhouse project despite the developers' failure to obtain the appropriate sewer approvals from New York City; that Washington Federal Savings and Loan disbursed funds to the VMT developers without receiving an accounting from them as to the use of those

funds; and, in fact, permitted over $1.3 million of liens to be filed against the Village Mall Townhouse property by unpaid subcontractors; that Washington Federal Savings and Loan approved the loan based on what appears an offhand oral appraisal report; and it accepted a mortgage from a corporation that did not even have title to the property. After exploring these facts, we will inquire as to whether the Federal examiners were lax in failing to uncover these factors and in not criticizing this loan.

The subcommittee is charged with overseeing the efficiency and economy of the activities and operations of the Federal bank regulatory agencies. Laxity in bank examination and supervision by the responsible Federal agencies affects us all. The billions of dollars invested in abandoned, vacant or defaulted real estate projects—investments which, in many cases, have gone uncriticized by bank regulators—increases the risk of bank failure, reduces the amount of funds available for consumer loans, and contributes to current high interest rates and inflation.

Our first witness this morning is Mr. Lawrence Rosano, president of Village Mall Townhouses, Inc.

Mr. Rosano, are these two gentlemen your counsel or are they associates?

STATEMENT OF LAWRENCE ROSANO, PRESIDENT, VILLAGE MALL TOWNHOUSES, INC.; ACCOMPANIED BY LEONARD I. WEINSTOCK, COUNSEL; AND ELKAN ABROMOWITZ, COUNSEL

Mr. ROSANO. They are my counsel.

Mr. ROSENTHAL. Will you please stand? Do you solemnly swear that the testimony you are about to give this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. ROSANO. I do.

Mr. ROSENTHAL. What is your full name?

Mr. ROSANO. Lawrence Rosano.

Mr. ROSENTHAL. What is your present address?

Mr. ROSANO. Forest Drive, Sands Point, N.Y.

Mr. ROSENTHAL. Are you currently the president of VMT, Inc.?

Mr. ROSANO. Upon the advice of counsel, I respectfully decline to answer that question on the grounds that the answer may tend to incriminate me within the meaning of the fifth amendment to the U.S. Constitution.

Mr. ROSENTHAL. Mr. Rosano, are you taking the position of refusing to answer any and all questions propounded by this subcommittee, other than our initial request that you state your name and address?

Mr. ROSANO. Yes.

Mr. ROSENTHAL. Mr. Rosano, as chairman of this subcommittee, I cannot accept your assertion that your answer to that question, that any question other than your name and address, would tend to incriminate you. Thus, I must demand that you answer the question.

I also must apprise you that your refusal to answer that question may be punishable as a contempt of Congress.

Mr. ROSANO. Upon the advice of counsel, I respectfully decline to answer that question on the grounds that the answer may tend to in-

criminate me within the meaning of the fifth amendment to the U.S. Constitution.

Mr. ROSENTHAL. Pursuant to the subpena served upon you, Mr. Rosano, do you have with you the books and records of VMT, Inc.

Mr. WEINSTOCK. Mr. Chairman, my name is Leonard Weinstock. I am one of the counsel for Lawrence Rosano and the corporation, Village Mall Townhouses, Inc.

Mr. ROSENTHAL. Mr. Weinstock, are you associated with a law firm?

Mr. WEINSTOCK. Yes, I am. The law firm is Weiss, Rosenthal, Heller, Swartzman & Lazar, 295 Madison Avenue, New York City.

With respect to the subpena, we have a number of documents relating to correspondence and documents sent by or on behalf of Village Mall Townhouses to the city of New York or any department, agency, or governmental subdivision.

However, with respect to item 2 of exhibit B and exhibit A, those documents were delivered to the attorney general for the State of New York, pursuant to subpenas. The specific subpenas are: A 34232, dated February 23, 1976; and subpena A 33486, dated October 16, 1974.

I turn these documents over to the committee.

Mr. ROSENTHAL. Mr. Rosano, are you going to take the fifth amendment in response to any of the questions here this morning other than your name and address?

Mr. ROSANO. Yes.

Mr. ROSENTHAL. I want to again repeat the warning that I earlier stated and then we will excuse you, in view of this testimony.

There are other questions that this subcommittee has that are pertinent to this inquiry. Your refusal to answer the subsequent questions may be punishable as contempt of Congress.

In view of your assertion, you are excused.

Our next witness is Mr. Frank Lietgeb, the president of Washington Federal Savings & Loan Association.

Would all of you identify yourselves for the record, please?

STATEMENT OF FRANK LIETGEB, PRESIDENT, WASHINGTON FEDERAL SAVINGS & LOAN ASSOCIATION; ACCOMPANIED BY RICHARD H. GRANT, SENIOR VICE PRESIDENT AND SECRETARY; STEPHEN H. SHANE, COUNSEL; AND ARTHUR W. LEIBOLD, COUNSEL

Mr. LIETGEB. Yes, sir. My name is Frank Lietgeb. I am president and chief administrative officer of Washington Federal Savings & Loan Association.

Mr. ROSENTHAL. Would you identify your associates?

Mr. LIETGEB. Sitting on my right is Richard H. Grant, senior vice president and secretary of Washington Federal. On my left is Stephen H. Shane of the firm of Demov, Morris, Levin & Shein. On my right is Arthur W. Leibold of the firm of Dechert Price & Rhoads of Washinton, D.C.

Mr. ROSENTHAL. Would you gentlemen who are officers of the bank please stand so that I can administer the oath to you.

Do each of you solemnly swear that the testimony you are about to give this subcommittee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. LIETGEB. I do.

Mr. GRANT. I do.

Mr. ROSENTHAL. You have a prepared statement, Mr. Lietgeb, so why don't you begin.

Mr. LIETGEB. We are pleased to respond to the subpena issued by the Committee on Government Operations to testify before this subcommittee. The subpena refers to all "transactions" between Washington Federal and Village Mall condominium, a project located in Bayside, Queens County, N.Y., and numerous documents relating to this project. As you may be aware, the Village Mall loan is the subject of litigation and, on advice of counsel, in order to protect the interests of the Association and its depositors, we could not supply the material to the committee unless directed to do so under the committee's subpena power.

I believe a brief background statement on Washington Federal is in order to place in proper perspective the remainder of this hearing. Washington Federal Savings and Loan Association was organized in 1941 under a Federal charter. It is a mutual thrift institution whose depositor members are the sole beneficial owners of the Association and they, together with the borrower members, have the sole right to vote on the selection of directors and other corporate matters. Mutual organizations such as Washington Federal have no stockholders and thus are not under any pressure to produce a profit for any entrepreneurial or speculative group of investors. All income, after allocations to reserves for losses and operating expenses, is credited to the Association's savings members in the form of interest on savings deposits and the balance to an undivided profit account. The rules and regulations for the operation of a Federal savings and loan association provide for the manner in which loss reserves are to be maintained and used. Both the reserve and undivided profits accounts and the Federal Savings and Loan Insurance Corporation, which insures the accounts of depositors up to $40,000, do in fact provide additional protection against loss for the depositor.

As of the end of 1975, Washington Federal had assets of $522 million of which $398 million was invested in residential mortgage loans. Over $237 million of these mortgages were insured or guaranteed by a Federal agency. On that date, the Association had deposit liabilities totaling $431 million representing the savings of approximately 100,000 account holders mostly located in Manhattan, the Bronx, Westchester, and Rockland counties in the State of New York. The average account balance of $4,300 indicates that the Association generally serves New York depositors of modest means.

During the year 1975, as in preceding years, the Association's operating income ratio compared favorably with the operating income ratios of other similar institutions in the New York district. Also, over the years since 1963, the Association's operating expense ratio has been continually reduced and is in line with institutions of similar size.

As is the case with associations operating mostly in the inner cities' areas suffering from the so-called urban blight, the Association has experienced losses caused by the write-off of mortgage investments on apartment houses in sections of New York which have been subject to deterioration, such as Brownsville in Brooklyn, East Harlem in Manhattan, and the South Bronx. As members of the committee are no

doubt aware, these areas of New York City have suffered severe deterioration characterized by the abandonment, vandalism, and destruction by fire of thousands of apartment houses. This disaster, which has struck many of the Nation's older metropolitan areas, results from a whole complex of government and private actions and reactions coupled with economic, social, and population trends which are clearly beyond the control of any single institution.

Over the past several years the Association's portfolio of housing loans, in the depressed areas of the city, has been significantly reduced and the Associations' current net worth is more than ample to cushion the effects of any additional writeoffs of such properties.

As noted earlier, the association was formed in 1941. From that time until early 1963, the association's chief executive officer was its founder, Mr. Floyd Cramer. In 1963, after a Federal Grand Jury indicted Mr. Cramer and several of his senior associates on charges stemming from a scheme to divert income from the association, Mr. Cramer committed suicide. The extreme sensitivity of savers to the slightest hint of problems at banking institutions is demonstrated by the fact that, even though the indictments and Mr. Cramer's suicide took place during a strike at all the major newspapers in New York City so that the news of the events were not widely known, and despite the fact that the offenses charged did not affect the association's fiscal integrity, a "run" on Washington Federal was triggered which resulted in the loss of several millions of dollars of deposits. This situation was finally contained only through the strenuous efforts of both the Association and Federal authorities.

At the time of this chaos, 13 years ago, with the former chief executive officer dead and all his senior associates under indictment and suspended from their positions with Washington Federal, the Federal Home Loan Bank Board, under Chairman Joseph P. McMurray, was faced with the responsibility of turning back the run on the association and finding new management of integrity and reputation to overcome the deleterious effect of the suicide and indictments.

Mr. McMurray recommended, and the association's board of directors approved, the appointment of Mr. George A. Mooney, former assistant financial editor of the New York Times and superintendent of banks of the State of New York, as the chief executive officer of the association. Under his administration, the association has largely overcome the adverse effect of the operations of the previous management, which principally included excessive reliance on nonrecurring income, from so-called points, to meet the normal regular operating expenses, and excessive concentration in high risk loans on tenement housing in areas which have since become slums.

The association is in sound fiscal condition, as recognized by the Federal Home Loan Bank Board as a result of its periodic examinations and by the association's own independent certified accountants. Assets and earnings have continued to increase and the association expanded its operations from 5 to 10 branches in the last decade. During this period, assets increased from $267 million to $522 million and net earnings have totaled $162 million, of which $150 million was credited in the form of interest to our savings customers, and $12 million was added to reserves and undivided profits.

In 1969, as housing costs continued to rise in the metropolitan area, Washington Federal became one of the early institutions interested in the financing of condominium housing. We believe that this new form of ownership offers a great many advantages including lower costs to the home buyer, more efficient use of materials and energy, and well-planned use of space, especially in areas of high land cost.

Since that time, therefore, Washington Federal has invested or committed some $50 million in the financing of condominiums in the metropolitan area which has resulted in the production of over 1,500 units of new housing.

We believe that this type investment fits squarely into the mandate contained in our charter to "provide for the sound and economical financing of homes." The Federal regulatory authorities some years ago specifically altered the definition of "home" in the regulations to include condominium units in an effort to promote this type of housing.

As one of the early lenders in this field, Washington Federal moved with extreme caution and developed procedures and underwriting criteria carefully designed to determine the salability of the proposed project and the soundness of the financing arrangements and construction.

I want to emphasize that these procedures have proved very effective over the years in producing a substantial volume of new housing for the citizens of New York. There is nothing casual about our approach to this type of financing. We consider most unfortunate the emphasis, as reported in the press, placed upon a single, routinely required credit report to the virtual exclusion of all the other documents procured and steps which the association follows in underwriting condominium loans.

Another aspect of condominium financing in New York State which we believe received insufficient emphasis during the previous hearings to convey an accurate and balanced picture to the public is the fact that the State of New York has a full and detailed regulatory apparatus designed to protect the interests of the purchasers of condominium units. All projects in the State must conform to the Attorney General's regulations which, among other things, require that a detailed offering plan presentation with full disclosure be prepared by the developer and given to each potential purchaser.

A review of this document will reveal, among other things, two matters which we believe should be emphasized in connection with the so-called Village Mall situation. First, on page 14 of the offering plan approved by the Attorney General is the following statement—in bold capital letters:

> If the purchaser's funds are expended towards the construction of the community and the community is not completed or the offering plan is not consummated for any reason, the purchaser may lose all or part of his down payment.

This quotation clearly discloses the conditions under which down payments for this condominium project were made.

Second, as noted on page 13 of the approved offering plan, down payments made by purchasers of the condominium units were deposited in a trust account, administered by the law firm of Wofsey, Certilman, Haft, Snow & Becker.

Thus, at no time were any of the funds of the purchasers of the units in the Village Mall project received, or held, by Washington Federal

Savings and Loan. Our position, and that of the 60-percent participating lender, Bankers Trust Company of New York, a $20-billion-asset-sized institution, was simply that of a construction lender advancing building loan money as the construction progressed. Only after the project was complete and the purchasers were ready to move into their units would the association actually enter into a financial arrangement with them. We do not believe there is anything contained in the offering plan or elsewhere that is misleading to the average person on this point.

Certainly, since the association never had possession of the down payment money and since there is nothing in the whole transaction that has given—or could give—rise to any legal responsibility on the part of the association with respect to these payments, there is simply no way that the Board of Directors of Washington Federal could authorize payment of the association's funds to those purchasers.

Indeed, if we were to voluntarily, without legal authorization, pay out the association's assets, the Federal supervisory authorities, whose principal responsibility is to safeguard the savings of depositors, might be required to take supervisory action.

Much was made at the close of the previous hearings on the subject of assessing "blame"—a word actually used—for the Village Mall situation. With the full benefit of hindsight this may be an easy and convenient exercise. For our part, we see the rapid and excessive escalation of interest rates and the runaway inflation of the last couple of years as the two principal ingredients producing the current disaster in the housing and construction industry. I suspect you would agree that all groups within society—the private sector and all levels of government—can share the blame for producing these conditions.

Indeed, at the height of the interest rate squeeze, I believe I recall a newspaper quote of Arthur Burns, chairman of the Federal Reserve Board, to the effect that if the housing industry had to be sacrificed to bring inflation under control, that would be the way it would have to be. Whether or not that constituted good public policy, something was bound to crack and, in the credit crunch, as we are all fully aware, crack it did.

The Village Mall project is but a single casualty. All one needs to do is look skyward, almost anywhere in the New York metropolitan and many other areas, to see an idle construction crane. We all know of the disastrous condominium situation in Florida and other places. Builders, both big and small, oldtimers and newcomers, have been forced to the wall all over the country. The construction trades are experiencing record unemployment levels. We at Washington Federal are thankful that the Village Mall represents the only condominium project we have financed which has gotten into trouble despite the national situation.

But I hope that the assessment of blame is not the purpose of these hearings. I don't think it is particularly productive nor truly the purpose of a congressional committee.

Rather, I hope we can put our heads together—in an atmosphere of mutual respect—not so much to rehash what went wrong, but to see what lessons can be learned for the future.

It is clear, for example, that arrangements other than those provided by New York law and regulation regarding down payments of condo-

minium purchasers must be made. We at Washington Federal have already made such an adjustment and our commitments to builders and developers now require that down payment money must be held in escrow until the project is finished and the buyers move in, rather than be used for construction.

It is interesting to note, in this connection, that a number of condominium sponsors in the New York area, in the interest of promoting and selling their projects, have voluntarily offered to escrow buyers deposits in this manner.

Foreclosure law and procedures constitutes another problem area. Under the best of circumstances, it takes about 5 months to complete a simple, single family foreclosure in New York State. This time delay results from the State's attempts to protect owners from having their properties summarily taken away by lenders. Clearly, such protection is essential to individual homemakers, but it can be questioned whether a more streamlined procedure might be appropriate where corporate borrowers, such as builders and developers, are concerned.

In the Village Mall case, the foreclosure process has already taken 18 months and appears it will take many more months to complete due to the complexities involved. Meanwhile, construction costs continue to rise, real estate taxes continue to accumulate on totally unproductive, half-completed buildings, and the special tax abatement provided by the State of New York which makes the Village Mall project so attractive to buyers will expire at the end of this year if the project is not completed by them. Thus, every day's delay adds to the costs of completing the project. This is particularly unfortunate in the Village Mall case because we believe that had the foreclosure proceeded expeditiously, Village Mall could have been completed at a cost, and sold at a price, which might have made it possible for all the parties and interests to be reasonably accommodated. As things now stand, it is questionable whether such a result can be obtained unless the legal complications are resolved promptly.

As we all know, lien laws and foreclosure procedures have generally been left to State jurisdiction by the Federal Government. Having been involved in the Village Mall case, however, and being aware of other instances of delay of this sort, we feel that serious study should be given to some procedure for separating the complex legal questions from the real estate itself so that clear title can be promptly vested in a responsible party. In this way, construction of uncompleted projects could be carried forward expeditiously with the possibility that the proceeds of sale would be sufficient to settle the interests of all the parties, thus effectively resolving the legal questions.

Perhaps the committee would like to consider the possibility of allowing the Federal regulatory agencies to set standards in this area with respect to federally related loans. Alternatively, perhaps the development of a model foreclosure statute could be promoted under Federal auspices.

With regard to the question of Federal regulatory control of individual mortgage loan underwriting, by regulated financial institutions, we think it would be a mistake to attempt to impose the judgment of a Government employee, whether stationed in Washington or locally, for that of the management of the individual lending institution. There has been considerable evidence, for example, in connection

with FHA-insured mortgage programs that the natural tendency of the private sector, when a Government agency takes over the ultimate responsibility for loan underwriting, is to rely upon the judgment of the governmental agency. I am convinced, therefore, that it would not be in the public interest to substantially increase the control, and thus the responsibility, the Federal regulatory authorities now have over lending practices. Nor do I think that it is necessary. In the savings and loan industry, the statistics on defaults and foreclosures have been exemplary even during the difficult times we have just experienced in the housing field. I believe Mr. Bryce Curry, president of the Federal Home Loan Bank of New York, gave you these figures at the previous hearing.

With regard to our own internal underwriting procedures, I can assure you that we have carefully reviewed everything that we have done. This review convinces me, as I believe it does the supervisory authorities, that regardless of anybody's individual view of the particular case, the processing of the Village Mall loan was in accordance with generally accepted practices, conducted honestly and seriously in an attempt to protect the interests of the association and its depositors.

In the final analysis, I think it is fair to say that there is no such thing as 100-percent protection against loss. We are, after all, supposed to be in the business of taking risk to produce housing and finance homeowners. From the point of view of marketability, our underwriting of the Village Mall project was right on target. When the units were first offered for sale, they were snapped up by an eager public, and virtually the entire project was sold out in 1 or 2 weekends. These sales all took place before Washington Federal advanced any money under the construction loan.

I fail to see how any conceivable level of governmental regulation or additional paperwork on the part of the association's staff could have protected against this particular default, which was largely caused by economic pressures. My principal regret, therefore, is that we have not been able to untangle the legal complexities of the situation and obtain clear title to the property so that we can complete it. We have reputable and reliable builders ready to do so, and if we can get underway soon, I am convinced that there is still a good chance of selling the units at a price which will make it possible to take into consideration the interests of all the parties in the transaction.

Thank you, Mr. Chairman.

Mr. GRANT. May I add that attached to this is a series of attachments which we would also like to place in the record.

Mr. ROSENTHAL. Without objection, it shall be included in the record.

[The attachments referred to follow:]

ATTACHMENT "A" 22

VILLAGE MALL TOWNHOUSES, INC.
141-unit Condominium
Bayside, Queens, New York

LOAN SUBMISSION TO WASHINGTON FEDERAL

This loan was referred to Washington Federal by Mr. Frederic B. Hof, Vice President of General Resources Associates, Inc., a mortgage brokerage company located at 20 East 46th Street, New York, New York 10017. Mr. Sidney N. Weniger is President of this firm and is a well-known and highly regarded mortgage broker operating in New York City since 1967.

The initial contact between Mr. Hof and Robert L. Callicutt, Vice President and Mortgage Officer of Washington Federal, occurred at the monthly Mortgage Bankers Association meeting in November, 1972. The Mortgage Bankers Association of New York is a trade organization consisting of members who are in the mortgage banking industry, i. e. commercial banks, savings banks, savings and loan associations, real estate investment trusts, etc. The monthly meetings of this organization serve as a market place where bankers and mortgage brokers have an opportunity to exchange information concerning the mortgage market and can discuss the placing of mortgage loans.

Mr. Callicutt had a passing acquaintance with Mr. Hof when Mr. Hof had been hired to do appraisal assignments for Lincoln First Real Estate Credit Corp., White Plains, New York, the firm by which Mr. Callicutt was previously employed. This company is a mortgage banking subsidiary of Lincoln First Banks, Inc., Rochester, New York, which is also the parent company for five commercial banks located throughout New York State with total assets exceeding $2 billion. At

the first meeting, Mr. Hof indicated that he was currently working on the placement of a construction loan and permanent mortgages for Village Mall. Mr. Callicutt informed Mr. Hof that Washington Federal has a favorable experience in this type of financing and Mr. Hof should submit the information concerning the project and its builders to Mr. Callicutt for review.

After that meeting, Mr. Callicutt did some preliminary research regarding Bayside by speaking with Mr. James Peel, Executive Vice President of the Ely-Cruikshank Company, Inc. This appraisal company is a leading firm in the field enjoying a nationwide reputation. Mr. Peel indicated that he had just completed an appraisal of a 21-story, twin high-rise apartment house project located adjacent to the project about which Mr. Callicutt was inquiring. This high-rise project was being built by the same developers. Mr. Peel indicated that, because of the extensive research he had just completed in Bayside, he was able to confirm to Mr. Callicutt immediately that there is a market for a 141-unit condominium. Mr. Callicutt called a second appraiser, Mr. Cornelius P. Mahon, who also has extensive experience in appraising condominiums, to research Bayside to confirm the appraisal opinion that Mr. Peel had given Mr. Callicutt. Mr. Mahon confirmed that the area was good and a market existed for this project.

On December 19, 1972, Mr. Hof submitted all the information Mr. Callicutt requested and, on December 20, 1972, Mr. Callicutt met with Mr. Hof for the purpose of inspecting the property and meeting with the builders. Mr. Callicutt thoroughly inspected the neighborhood, which is a well-maintained, upper middle income community. Mr. Callicutt discussed with Mr. Rosano, the amount, rate, terms, and conditions of the loan.

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UNDERWRITING OF THE LOAN AND CREDIT ANALYSIS OF THE DEVELOPER

The usual and customary practice, generally followed by construction lenders underwriting this type of loan and followed by Washington Federal in the Village Mall case, involves the collection and analysis of the following information:

1. Construction plans of the improvement
2. Specifications of the materials to be used
3. Survey of the parcel
4. Cost projection setting forth direct construction items (material and labor) and indirect construction items (legal fees, architect's and engineering fees, interest, etc.)
5. Market feasibility study
6. Two appraisals
7. Resume of the builder's previous building experience
8. Credit references of the builder
9. Credit report on the corporation
10. Credit report on the individuals

The two appraisals cost $6,000 each. Professional review of the plans, specifications, and cost estimates by an architectural and engineering firm were also required. The firm of Merritt and Harris, Inc., 110 East 42nd Street, New York, New York was employed for this purpose. This firm is one of the largest and most reputable in the field and operates throughout the United States. Its services are used by major commercial banks, savings banks, and savings and loans in the construction lending business. Merritt and Harris' fee was $9,500.

The developer of this project was a partnership consisting of

Mr. Lawrence Rosano and Mr. Michael Newmark. Mr. Rosano, according to the resume submitted to Washington Federal, had been in the construction business since 1946 and, since 1953, had been building residential properties, principally in Long Island, New York. The following is a list of the properties which he constructed prior to his becoming a partner of Mr. Newmark.

Type of Property	Date	Value
1000 homes in the Huntington-Commack, N. Y. area	1953-63	$ 20,000,000.00
80-unit apartment house project-Bridgeport, Connecticut	1964-65	1,600,000.00
109 single-family homes-Farmingdale, L. I., New York	1966-67	2,180,000.00
52 3-story apartments-Bayside, New York	1967-68	1,000,000.00
45 2-story houses-Bayside, New York	1968	3,000,000.00
	TOTAL	$ 27,780,000.00

Mr. Newmark was a partner of Newmark, Posner, Mitchell, Inc., a Manhattan based advertising and marketing company.

In 1969, Rosano and Newmark became partners. They developed and built the following properties:

Name	Type of Property	Value As Of 9/30/72
Baytown House Apartments	30-unit 4-story garden apartments Bayside, New York	$ 571,000.00
Colonial House Apartments	22-unit 4-story apartment houses Bayside, New York	409,000.00

Name	Type of Property	Value As Of 9/30/72
*Bell Bay Racquet Club, Inc.	tennis and swimming club Bayside, New York	2,433,000.00
Bell Plaza Management Corp.	6-story office building Bayside, New York	3,036,000.00
Village Mall Apartments	9-unit apartment building Bayside, New York	595,000.00
Village Mall at Bayside	46 2-family homes Bayside, New York	1,461,000.00
**Village Mall at Hillcrest	450 condominium units Bayside, New York	21,500,000.00

* Purchased and completely renovated
** Under construction

Washington Federal confirmed Mr. Rosano's previous building experience as well as the building experience of the partnership of Rosano and Newmark by inquiries with the lending institutions involved. Among such lenders were Security National Bank, HNC Real Estate Investment Trust, Franklin National Bank, National Bank of North America, Bayside Federal Savings and Loan Association, and Whitestone Savings and Loan.

Washington Federal also confirmed that the Village Mall at Hillcrest project was under construction and was a little over 80% complete, approximately 77% of the units had been sold, and $12 million of the $16 million loan had been disbursed. This project consists of 450 units in two high-rise towers located at 150th Street and Union Turnpike, Queens, New York. Permanent mortgages for the Hillcrest Condominium were being provided by a consortium of banks as follows: Jackson Heights Savings and Loan (now State Savings and Loan), Walt Whitman Federal Savings and Loan, and The Hamburg Savings Bank.

HNC Real Estate Investment Trust indicated that the builders had been approved for a $41 million construction loan covering a twin high-rise project located adjacent to the Village Mall Townhouses site. Other major participants with HNC in this project were Bank of America, Chemical Bank, National Bank of North America, and General Electric Credit Company.

Bayside Federal Savings and Loan Association also reported previous satisfactory lending experience with the developer.

Financial statements as of September 30, 1972 and August 31, 1973 were prepared by Louis Goldberg & Company, Certified Public Accountants, 1476 Broadway, New York, New York. The September 30, 1972 personal financial statement of Lawrence Rosano indicated cash in banks of over $700,000 and a net worth in excess of $5,900,000. Mr. Newmark's financial statement indicated cash in banks of $567,000 and a net worth in excess of $6,200,000. The financial statements showed that the various projects, which were jointly owned by Rosano and Newmark, had a total value exceeding $28,000,000 with capital equity of $12,153,000. Financial statements of August 31, 1973 compared favorably to the previous statements of September 30, 1972.

Washington Federal required the execution of personal guarantees by the developer in two phases. Phase I was a guarantee of completion of the project. Phase II was a guarantee of the debt until the project was 50% sold as evidenced by signed contracts.

Washington Federal obtained a Dun & Bradstreet credit report dated June 1, 1973. This report was on the corporation, Village Mall Townhouses, Inc. The report confirmed the antecedent history of the builders, the properties which they owned jointly, and did not reveal

anything of a derogatory nature. Personal credit reports were obtained on Messrs. Rosano and Newmark from Retailers Commercial Agency dated January 29, 1973. The principal purpose of these reports was to check public records to determine if there had been any previous litigation involving these persons. The reports indicated the public records were clear.

Two independent appraisals were ordered. The first from Ely-Cruikshank Co., Inc. dated March 15, 1973 and the second from Cornelius P. Mahon Associates dated April 2, 1973.

ATTACHMENT "B"

Village Mall - Litigation Status

The building loan mortgage closing was held on October 30, 1973, at which time Village Mall Townhouses, Inc., the putative owner of the property, executed and delivered to Washington Federal Savings and Loan Association (WFSL) its promissory note for $5,000,000, secured by a mortgage on the Village Mall Property. At the same time, the Developers, Messrs. Newmark and Rosano, executed a guaranty in favor of WFSL of payment of the note and performance and completion of the terms of the building loan agreement. At the closing, Security Title and Guaranty Company (Security) delivered its commitment of title insurance which, inter alia, certified that Village Mall Townhouses, Inc. (VMT) was the owner of the subject premises.

On November 27, 1973, Bankers Trust Company (Bankers) entered into a participation agreement with WFSL, wherein Bankers agreed to fund 60% of the building loan mortgage advances. Bankers had theretofore made their own independent investigation of this project and apparently concluded that it was an appropriate investment for them.

At the closing, and periodically thereafter, WFSL and Bankers advanced to VMT certain sums pursuant to the building loan agreement. Each advance was based on certifications from Merritt and Harris, the supervising engineer engaged by WFSL for this project, to the extent of the percentage completed and upon an update of the title report. The total advance was

approximately $2,600,000, of which Bankers had advanced $1,600,000 and WFSL the balance.

The reports of Merritt and Harris and WFSL's staff indicate that construction progress was satisfactory until August 6, 1974, when WFSL learned that subcontractors had walked off both the VMT project and the adjacent high-rise project, also owned by the Developers.

On inquiry, the Developers told us that inflation and high interest costs had created cost overruns on the high-rise project and Hartford National Corporation (HNC), the lead mortgage lender on that project, had refused to approve an increase in the mortgage. The subcontractors who were working on both the VMT and high-rise projects refused to continue on either as they were not being paid on the high-rise.

On September 3, 1974, Mr. Newmark and his attorney, Mr. Certilman, met with WFSL to discuss the VMT and high-rise projects. They stated that a number of purchasers of condominium units had requested refunds and asked if WFSL would advance $50,000 under the building loan mortgage for work done on building number three. The total value of the work on building number three at that time was $352,000, but no advances for building number three had been made because of the sewer easement situation.* Although reluctant to make this advance, we agreed to do so after speaking with Daniel Furlong, Esq. of the New York Attorney General's office. Mr. Furlong advised us of the importance to the Attorney General's office of Mr. Newmark's bringing such a letter to a meeting

*For a more complete discussion of the sewer easement situation and its treatment, see the annexed material.

scheduled for the next day. Being late in the day, unable to speak with counsel, WFSL wrote a letter agreeing to make a $50,000 advance and delivered it to Mr. Newmark.

When a title insurance continuation was ordered, as required to make a building loan advance, the lien of a $41,000,000 second mortgage held by HNC had been placed on the VMT property without the subordination and release provisions to our building loan advances and end loans which were necessary. Upon inquiry, WFSL learned that this second mortgage was given as additional security for a loan increase on the high-rise project. WFSL informed the borrower that the appropriate subordination and release provisions would have to be executed by HNC before any further building loan advances could be made by WFSL. In addition, several mechanic's liens also appeared in the continuation.

WFSL now contacted the lenders involved with the Developers including HNC, National Bank of North America, Security National Bank and several of the major subcontractors who were doing work for them. We learned: (1) National Bank of North America had extended a $12,000,000 land loan to the Developers on a separate property purchased after the closing of WFSL's building loan on VMT. Payments on this land loan were delinquent and in August of 1974, National Bank of North America had started a foreclosure proceeding. (2) Security National Bank reported that its loan on the Hillcrest Condominium (another project started long before VMT) was delinquent because there were more than 100 units left unsold, creating additional expense to the Developers and contributing to their cash flow problems. (3) HNC reported a default on the

high-rise, that it was evaluating the project with other potential general contractors, but because of the complexities it would take some time before they could arrive at any conclusions. (4) The subcontractors gave a vote of confidence in the Developers and said they would come back to complete the project were they to proceed.

On September 5, 1974, WFSL met with the representatives of Bankers and gave all of the information described above. On September 30, 1974, Mr. Rabinowitz of Bankers, together with representatives of WFSL, met with the Developers to discuss the status. Mr. Newmark advised that he was confident that the Hillcrest Condominium and high-rise project problems would be resolved, that the foreclosure on the land loan would not hurt him (because, in his opinion, the property was worth more than $40,000,000 after completion of the zoning change) and that while the Board of Estimate had not approved the revised sewer plan at the September 10 meeting, it would be on the October 10 calendar for approval. After confirmation of the Board of Estimate status by Commissioner Samowitz of the Department of Water Resources, the Developers were advised that a $400,000 advance under the building loan would be made to get this project started again prior to the final sewer plan approval, but only if all of the liens (now being filed in increasing numbers), including the HNC mortgage, were cleared up. A number of dates were set at which this advance was to be made but each time, the appropriate documents to be provided by HNC and/or releases of mechanic's liens were not produced.

After thorough analysis and discussion between loan officers of Bankers and WFSL, it was decided that a foreclosure action would be necessary

to protect the loan investment. Therefore, on October 21, 1974, the foreclosure action was commenced. The foreclosure action proceeded in routine manner until March 21, 1975, when counsel for WFSL moved for a summary judgment of foreclosure. After service on opposing counsel, but before the motion was submitted to the Supreme Court, Queens County, WFSL was advised by Security that title to the property was in the name of "Village Mall Townhouses", a partnership, and not "Village Mall Townhouses, Inc.", a corporation which was the named mortgagor. Because of this apparent defect in title, the motion for summary judgment was withdrawn. The title defect had apparently been caused by several transfers of title between the various partnerships and corporations owned by the Developers which were missed in the routine title search by Security prior to the initial closing. Because of the defect, a number of mechanic's lienors have claimed lien rights superior to that of WFSL in the property, the purchasers of condominium units have also asserted a senior position, and, further, after the title defect became known, Bankers sued WFSL for recission, claiming that because of a "mutual mistake" (the title defect), Bankers is entitled to the return of all moneys advanced by it to WFSL.

Two actions were brought by individual condominium purchasers against WFSL seeking return of their contract deposits. Each of these individual actions were successfully defended, resulting in decisions favorable to the Association.

The Supreme Court, Queens County, has ordered a joint trial of the foreclosure action, the contract vendees' class action against WFSL and others and the Bankers action against WFSL. The various parties to these actions have

been engaged in pre-trial discovery proceedings and it is anticipated that the matters will be placed on the trial calendar in April 1976.

As a final step in clearing title so that the VMT project may be completed, the foreclosure must be completed and WFSL's first mortgage lien recognized. All parties must be joined, including those who had executed subscription agreements for the purchase of condominium units. No relief is sought against these persons by WFSL other than a determination of their rights, as lienors, in the property, if any, a determination to be made by the trial court when the joint trial is held for the various actions described above. The actions with Bankers and Security must similarly be resolved.

From the discovery of the title defect, extensive "work out" discussions were held among representatives of WFSL, Security, Bankers, the Attorney General, the Developers, several subcontractors and other interested persons in an attempt to determine if the project could be completed.

However, in the middle of the discussions during the early summer of 1975, an involuntary petition in bankruptcy was filed against the Developers and their related corporations and it became almost impossible because of this latest complication to reach any satisfactory "work out". Bankers has taken the position that it will not participate in any "work out", and is only interested in receiving the sums heretofore advanced. Because of the default and work stoppage, many mechanics and materialmen filed liens against the property. In an effort to partially resolve the title issue, Security went forward with settlement arrangements among Security, the mechanic's lienors and the Developers, pursuant to which Village Mall Townhouses (the partnership)

executed and delivered a correction deed naming VMT as the owner of the property, with VMT then executing and delivering a confirmatory mortgage. These documents were recorded in August, 1975. All persons who filed valid mechanic's liens against the premises have now settled their claims and given releases for their liens to Security.

WFSL management hopes that if the pending litigations are promptly and satisfactorily resolved, by judgment or otherwise, the project can be completed and arrangements made to give to each of the condominium purchasers some credit toward the purchase of a unit in the completed building or a refund. However, WFSL cannot make any commitment on this point at this time because of the uncertainties resulting from the various litigations.

ATTACHMENT "C"

VILLAGE MALL

SEWER EASEMENT

Washington Federal (WFS&L) followed the usual practice in construction lending of verifying that a building permit had been issued with no exceptions. WFS&L's inspecting architects, Merritt & Harris (M&H), reviewed the building permit and the various related permits. These permits did not indicate any exceptions that would prohibit the builders from hooking up to the existing sewer system in the bed of 26th Avenue. However, at the initial closing of the construction loan, WFS&L's attorneys reviewed the title report, which raised an exception of an easement running from 26th Avenue, underneath Building #3, to the adjacent high-rise complex. The easement had been granted to the City of New York as one of the conditions to the closing of 210th Street, as set forth in an agreement under date of July 17, 1973 between the City and the developers, and prohibited the erection of any structures in the easement area. The developers, Rosano and Newmark (R&N), indicated, at the closing of the construction loan, that the overall sewer system had been initially approved by the City but that modifications had been requested to the original approval so as to include the townhouse project. R&N indicated that the situation would be resolved within a month or two, the revised sewer system would save construction expense and R&N did not intend to do any construction work on Building #3 until the matter had been finally resolved. WFS&L instructed M&H, based on a mutual agreement with R&N, not to include any disbursements for Building #3 in the authorization for loan advances until satisfactory resolution of the problem. WFS&L was assured that all of the buildings in the townhouse project could be legally connected to the existing sewer line running in the bed of 26th Avenue.

On March 8, 1974, M&H discussed the sewer problem in its report to WFS&L and recommended that advances be suspended pending clarification of this situation. WFS&L then asked M&H to investigate into and discuss this problem directly with R&N. M&H reviewed the entire matter with R&N and by letter of March 13, 1974, M&H indicated to WFS&L that they had been informed that this problem would be resolved shortly, that M&H would be given the latest plans and specifications for the revised sewer system and recommended payment of the next advance.

When construction stopped in August of 1974, WFS&L, seeking evidence that the revised overall sewer system had been approved, spoke to Commissioner Charles Samowitz of the Department of Water Resources of the City of New York. Commissioner Samowitz confirmed that the revised overall sewer system had been fully approved by their Department as to design and specifications, but that final approval had to be evidenced by a formal resolution to be adopted by the Board of Estimate of the City, hopefully at the meeting of September 10, 1974. Subsequently, WFS&L was informed that the resolution approving the revised sewer plan was not presented at the September 10th meeting of the Board of Estimate because of insufficient time to place it on the calendar, but that the matter was on the calendar for the October meeting. However, by the time of the October meeting, the high-rise project had stopped construction, the necessary bonds required to be posted for the revised sewer system agreement were not available and the matter was laid over. After commencement of the foreclosure action, with the aid of the New York State Attorney General, WFS&L was able to confirm that the townhouses

could tie into the existing sewer line running in 26th Avenue, independent of the ultimate fate of the high-rise, as evidenced by letter of April 11, 1975 from Joseph T. Miller, Assistant Commissioner of the Department of Water Resources, Environmental Protection Administration, City of New York.

CONCLUSION

At all times, before the building loan closing, during construction and after stoppage (even until now), access to the sewer system in 26th Avenue was available to the townhouses. Because of the consent granted to the City running under a portion of Building #3, that building could not have been completed (i.e., about 20% of Building #3 would have been effected) without a revised sewer system. All parties involved were making conscientious efforts to arrive at a solution and but for the intervention of work stoppage, had so done. The City has now released its easement affecting Building #3 and the entire issue is moot.

Mr. ROSENTHAL. As you know, Mr. Lietgeb, we are very much interested in how this loan was begun and processed, and what took place. I think it might be useful if you read part of attachment A.

Mr. LIETGEB. Attachment A relates to loan submission to Washington Federal. It reads as follows:

This loan was referred to Washington Federal by Mr. Francis B. Hof, vice president of General Resources Associates, Inc., a mortgage brokerage company located at 20 East 46th Street, New York, N.Y. 10017. Mr. Sidney N. Weniger is president of this firm and is a well-known and highly regarded mortgage broker operating in New York City since 1967.

The initial contact between Mr. Hof and Robert L. Callicutt, Vice President and Mortgage Officer of Washington Federal, occurred at the monthly Mortgage Bankers Association meeting in November 1972. The Mortgage Bankers Association of New York is a trade organization consisting of members who are in the mortgage banking industry; that is, commercial banks, savings banks, savings and loan associations, real estate investment trusts, and so forth. The monthly meetings of this organization serve as a market place where bankers and mortgage brokers have an opportunity to exchange information concerning the mortgage market and can discuss the placing of mortgage loans.

Mr. Callicutt had a passing acquaintance with Mr. Hof when Mr. Hof had been hired to do appraisal assignments for Lincoln First Real Estate Credit Corp., White Plains, New York, the firm by which Mr. Callicutt was previously employed. This company is a mortgage banking subsidiary of Lincoln First Banks, Inc., Rochester, New York, which is also the parent company for five commercial banks located throughout New York State with total assets exceeding $2 billion. At the first meeting, Mr. Hof indicated that he was currently working on the placement of a construction loan and permanent mortgages for Village Mall. Mr. Callicutt informed Mr. Hof that Washington Federal has a favorable experience in this type of financing and Mr. Hof should submit the information concerning the project and its builders to Mr. Callicutt for review.

After that meeting, Mr. Callicutt did some preliminary research regarding Bayside by speaking with Mr. James Peel, Executive Vice President of the Ely-Cruikshank Company, Inc. This appraisal company is a leading firm in the field enjoying a nationwide reputation. Mr. Peel indicated that he had just completed an appraisal of a 21-story, twin high-rise apartment house project located adjacent to the project about which Mr. Callicutt was inquiring. This high-rise project was being built by the same developers. Mr. Peel indicated that, because of the extensive research he had just completed in Bayside, he was able to confirm to Mr. Callicutt immediately that there is a market for a 141-unit condominium. Mr. Callicutt called a second appraiser, Mr. Cornelius P. Mahon, who also has extensive experience in appraising condominiums, to research Bayside to confirm the appraisal opinion that Mr. Peel had given Mr. Callicutt. Mr. Mahon confirmed that the area was good and a market existed for this project.

On December 19, 1972, Mr. Hof submitted all the information Mr. Callicutt requested and, on December 20, 1972, Mr. Callicutt met with Mr. Hof for the purpose of inspecting the property and meeting with the builders. Mr. Callicut thoroughly inspected the neighborhood, which is a well-maintained, upper middle income community. Mr. Callicutt discussed with Mr. Rosano, the amount, rate, terms, and conditions of the loan.

Mr. ROSENTHAL. Had Mr. Hof been Mr. Callicutt's boss in his previous employment?

Mr. LIETGEB. No, sir, he was just doing appraisal work in the same firm, not as an employee of the same corporation. He was not his superior.

Mr. ROSENTHAL. But, had Callicutt worked for that firm previously?

Mr. LIETGEB. Yes, sir. Now, that was the initial contact from which we then went into getting all of the information which is on page 3 of the same exhibit—the underwriting analysis of the developer. All of the 10 items that we have listed are required before the association makes any determination to approve the mortgage loan.

Do you want me to read that?

Mr. ROSENTHAL. We will include this into the record, and I will just ask some questions.

Was this the largest condominium loan that Washington Federal had ever made?

Mr. LIETGEB. No, sir.

Mr. ROSENTHAL. Could you put it into perspective, giving us what your previous experience has been?

Mr. LIETGEB. We have been engaged in two other large ones. One is called the Stonegate Development in Rockland County; and the other one, the High Point unit in Hartsdale, Westchester County.

Mr. ROSENTHAL. If this were not the largest loan you had ever made, was it the second largest?

Mr. LIETGEB. Overall, I would say it was probably the third largest. The others were just advanced in segments; all funds were never advanced at any one time. So the exposure of the association was not in excess of $5 million at any one time.

Mr. ROSENTHAL. This was not a construction loan in the usual sense. In other words, you made a loan to each individual purchaser. Is that correct?

Mr. LIETGEB. The end loan would have been to each individual purchaser, but the construction loan is to the developer.

Mr. ROSENTHAL. Was each individual purchaser required to come to your office and to submit credit applications and so forth?

Mr. LIETGEB. They are not required until the closing. But in this particular situation, because the sales had gone on so favorably, to help speed up the paperwork we accepted the applications as they were received.

Mr. ROSENTHAL. I have heard from some of these purchasers that they physically went to Washington Federal and were interviewed and submitted loan information, and so forth.

Mr. LIETGEB. Some of them did come into the association. That is one way you can process the application—by getting all of the credit information, et cetera.

Mr. ROSENTHAL. I understand. I merely want to make a distinction so that I understand it.

In the usual rental housing where there is a construction loan, the prospective tenants or the prospective purchasers in a cooperative, for example, would never have occasion to go to the bank for an individual loan. You had to approve the credit of each individual purchaser?

Mr. LIETGEB. That is correct.

Mr. BROWN. Would the gentleman yield?

Mr. ROSENTHAL. Surely.

Mr. BROWN. You are saying that you made the construction loan to the developer, which was one loan.

Mr. LIETGEB. That is correct.

Mr. BROWN. But, because people had shown interest in the finished apartments, they had made down payments and came into Washington Federal to apply for mortgage loans in anticipation of the completion of construction. Through the individual loans they would buy their condominium unit upon which they had made the downpayment.

Mr. LIETGEB. That is correct.

Mr. BROWN. But this was just in anticipation of the conclusion of the construction loan and then the purchases of the individuals; is that right?

Mr. LIETGEB. That is correct; we were treating them the same way we would treat any applicant for a single-family home loan.

Mr. ROSENTHAL. That is the point I am trying to make. You were treating these condominium purchasers the same way you would treat an applicant for an individual home loan.

Mr. LIETGEB. That is correct, sir.

Mr. ROSENTHAL. Mr. Lietgeb, did any officers or directors of Washington Federal Savings & Loan ever receive any moneys or goods or services from Messrs. Newmark or Rosano or Village Mall or any entity controlled by them other than the compensation, interest, and fees referred to in the contract for building loan entered into between Village Mall and Washington Federal?

Mr. LIETGEB. None, to my knowledge.

Mr. ROSENTHAL. When you say, "None, to your knowledge," would you want to amplify that?

Mr. LIETGEB. No one volunteered to tell me that they received any money.

Mr. ROSENTHAL. You didn't?

Mr. LIETGEB. I didn't.

Mr. ROSENTHAL. What was the total amount of commitment fees and any other fees which Washington Federal received in connection with the Village Mall loan?

Mr. LIETGEB. $170,000.

Mr. ROSENTHAL. Had you ever received a fee that large from any other project?

Mr. LIETGEB. Yes, sir.

Mr. ROSENTHAL. Which project was that?

Mr. LIETGEB. The total of the High Point and probably Stonegate.

Mr. ROSENTHAL. Which of those two projects is in Westchester?

Mr. LIETGEB. High Point.

Mr. ROSENTHAL. That hasn't been sold out yet, has it?

Mr. LIETGEB. No, sir.

Mr. ROSENTHAL. How long has that been under construction?

Mr. LIETGEB. We are now talking about the fourth segment of a project. The first three have been completed and sold out. The fourth is probably 50-percent sold.

Mr. ROSENTHAL. Has that moved according to expectations?

Mr. LIETGEB. Very much so; very favorably.

Mr. ROSENTHAL. How much interest did Washington Federal Savings & Loan credit to itself as a result of the Village Mall loan?

Mr. LIETGEB. Of the $170,000?

Mr. ROSENTHAL. Yes.

Mr. LIETGEB. All of it.

Mr. ROSENTHAL. How about interest on the payments on the loan?

Mr. LIETGEB. I think that we have that record here, sir; just a moment.

Mr. BROWN. While he is looking for that, what did the $170,000 consist of? You said it was the total amount paid in connection with the construction loan. Was that purely the commitment fee?

Mr. LIETGEB. That is all for the construction loan; yes, sir.

Mr. ROSENTHAL. When you talk of a "commitment fee," what it is?

Mr. LIETGEB. This is a negotiated fee with the builder.

Mr. ROSENTHAL. They gave you a fee for your making this loan for which you were subsequently to receive interest payments?

Mr. LIETGEB. That is correct.

Mr. ROSENTHAL. Described in another way, it is a kind of conventional point system, isn't it?

Mr. LIETGEB. It may be viewed that way; yes, sir.

Mr. ROSENTHAL. Is that legal?

Mr. LIETGEB. It has been done for umpty-ump years. It is a normal practice.

Mr. ROSENTHAL. How did you treat that $170,000 on the books?

Mr. LIETGEB. Under our regulations, we are permitted to take an amount equal to 2 percent of the construction amount into income immediately. The balance is deferred over a period of 10 years.

Mr. ROSENTHAL. Do you have with you the original mortgage application by Newmark and Rosano?

Mr. LIETGEB. I believe we do.

Mr. ROSENTHAL. In the mortgage application, did Newmark and Rosano agree to cooperate with you in a credit check?

Mr. LIETGEB. The commitment that was issued by the association indicates that the approval of the loan was subject to getting appropriate credit and appraisals to support our loan.

Mr. ROSENTHAL. Could you produce today the credit report of Retail Credit Co. on Messrs. Newmark and Rosano?

Mr. LIETGEB. I think the entire file has to be produced because, again, using any single piece of paper does not convey the true——

Mr. ROSENTHAL. No; no. We are going to try to cover every piece of paper. But just get the credit report of Retail Credit. Do you have that handy?

Mr. LIETGEB. Yes, sir.

Mr. ROSENTHAL. Will you read to us the beginning where it says, "Credit Record"?

Mr. LIETGEB [reads]:

January 29, 1973. No credit shown on the inquiry. We corresponded with subject and tried to contact him at office on several occasions, but to date have received no reply.

Mr. ROSENTHAL. How much did you pay for that credit report?

Mr. LIETGEB. I think the records will probably bear out that it was $7.50 or some such amount.

Mr. ROSENTHAL. I think it was $5.

Mr. LIETGEB. But because of the volume that the association generates, we do get some sort of a favorable rate.

Mr. ROSENTHAL. For our records, was it $5, or was it $7.50?

Mr. LIETGEB. We don't have that with us. I don't think it makes any diffierence whether it is $5 or $7.50.

Mr. ROSENTHAL. How do you know that doesn't make a difference?

It makes a difference to me. At any rate, are there any other credit reports in the file?

Mr. LIETGEB. Yes, sir.

Mr. ROSENTHAL. Would you then pull out?

Mr. LIETGEB. This is our entire credit file, if you will, and the information we used in determining whether we would make the loan.

Mr. ROSENTHAL. You had the financial statements on Newmark and Rosano, didn't you?

Mr. LIETGEB. That is correct.

Mr. ROSENTHAL. Are any of them certified?

Mr. LIETGEB. There is no indication that they are not audited. And under normal procedures, as they existed in 1972, 1973, and 1974, it is my understanding——

Mr. ROSENTHAL. Would you read to us the letter from Louis Goldberg & Co., certified public accountants, regarding the August 31, 1972, financial statement?

Mr. LIETGEB [reads]:

> The accompanying exhibits comprise a financial statement of you and your related properties as of September 30, 1972. Please note that the minority interest on Baytown Apartments and Colonial House Apartments is listed under liabilities. All factors of an intercompany relationship were eliminated. Realty values, including land, are predicated on appraisals by an outside agency. All other assets and liabilities were obtained from books of accounts. The normal auditing procedures of confirmation have not been followed due to lack of time * * *

Mr. ROSENTHAL. Mr. Lietgeb, would you read that again?

Mr. LIETGEB [reads]:

> The normal auditing procedures of confirmation have not been followed due to the lack of time. It is my opinion that the figures clearly present your financial position as of September 30, 1972.

Mr. ROSENTHAL. Was that their only accountant's statement?

Mr. LIETGEB. Yes, sir.

Mr. ROSENTHAL. And he said that the normal auditing procedures had not been followed. In any of the statements you received from Newmark and Rosano, were they certified?

Mr. LIETGEB. This is considered an audited statement, sir.

Mr. ROSENTHAL. What does the word "certified" mean in your profession?

Mr. LIETGEB. If there are any exceptions or any qualifications, the CPA must disclose them in his opening comments.

Mr. ROSENTHAL. Either you or Mr. Callicutt at some time must have read that commercial credit report where it said that they couldn't be contacted. Would that be a warning signal to you that these people were less than forthright?

Mr. LIETGEB. In light of the other information on that credit report—the one that we relied on mostly was with reference to legal actions, judgments, liens, and et cetera—it did not bother us that much because we were still in contact with them and could get it.

Mr. ROSENTHAL. Did it bother you a little bit?

Mr. LIETGEB. No.

Mr. ROSENTHAL. So you had a $5 credit report that said that they couldn't be contacted and you had a statement from their own accountant that said normal auditing procedures had not been followed. What did you have of a positive nature?

Mr. LIETGEB. Mr. Chairman, the quote is: "The normal auditing procedures of confirmation . . ." That is his qualification. That is entirely different from saying the normal auditing procedures for the entire organization.

Mr. ROSENTHAL. Mr. Lietgeb, we don't want to be contentious. In other words, their own accountant—not your accountant and not my accountant—Louis Goldberg said that the normal auditing procedures had not been followed. What that means, when translated into simple

English, is that whatever he was giving you was information that Newmark and Rosano had passed on to him and that he did not independently verify.

Mr. LIETGEB. I think you would have to read all of the 10 items that we used, which were spelled out on page 3 of this exhibit, all of which were made by independent people. The CPA is a licensed man; he is a professional. I think we have every right to believe that he is giving us an honest statement.

Mr. ROSENTHAL. I think he did too, but he was protecting himself when he said that normal auditing procedures weren't followed.

Mr. LIETGEB. As far as confirmation. I think there is a difference, Congressman.

Mr. ROSENTHAL. In other words, your judgment was that this was satisfactory. What else did you know about these fellows? Had they had much experience?

Mr. GRANT. Could I make one comment, sir? Regardless of whether you consider that a substantial qualification or not, which we in our experience did not, the fact is that the financial statements were in fact accurate. And nothing that has happened since has given us any indication that there was anything about those financial statements which was not in fact accurate.

Mr. ROSENTHAL. Am I correct in stating that the attorney general of the State of New York is questioning the accuracy of those statements?

Mr. SHANE. I have been in daily touch with the attorney general in connection with this matter and have been negotiating with him for a long time because of his interest.

Mr. ROSENTHAL. Has any process occurred in the last 48 hours based on these statements?

Mr. SHANE. Absolutely not. We have received an answer from the attorney general in the foreclosure action which does not raise the slightest question about the accuracy of the accountant's statement.

Mr. ROSENTHAL. You had the unverified accountant's statement which satisfied you. That is a business judgment and perhaps your judgment is better than ours. What other investigation did you make of these people?

This is the second largest loan you ever made in the history of your bank.

Mr. LIETGEB. It should also be pointed out that the $5 million was not a loan of Washington Federal; we were only a 40-percent participant and someone else was 60 percent.

Mr. ROSENTHAL. You had laid off 60 percent with Bankers Trust. Did that make you feel a little freer in the operation?

Mr. LIETGEB. Yes; it takes it out of the category of a huge loan, as you put it.

Mr. ROSENTHAL. Nonetheless, even a $2 million loan was significant for your institution, wasn't it?

Mr. LIETGEB. It is significant; yes, but it was not unsound or unsafe. It is not uncommon.

Mr. ROSENTHAL. Tell us what other investigation you made of these fellows. What was their experience and background?

Mr. LIETGEB. Mr. Rosano, according to the resume submitted to Washington Federal, had been in the construction business since 1946;

and, since 1953, had been building residential properties, principally in Long Island, N.Y.

Mr. ROSENTHAL. That was Rosano?

Mr. LIETGEB. That is Mr. Rosano; yes.

Mr. ROSENTHAL. He had been building one- or two-family houses.

Mr. LIETGEB. According to the file, he built 1,000 homes in Commack, N.Y., valued at $20 million; he put up an 80-unit apartment house project in Bridgeport, Conn., for $1,600,000; he built 109 single-family homes in Farmingdale for $2,180,000; he put up 52 three-story buildings in Bayside in 1967, at a $1 million value; and he had 45 two-story houses in Bayside, N.Y., in 1968, worth $3 million.

After the partnership was formed, they put up a 30-unit four-story garden apartment in Bayside, with a value of $571,000; 22-unit four-story apartments of over $409,000; they were instrumental in rebuilding the Bell Bay Racquet Club, a $2,433,000 project. They put up a six-story office building in Bell Plaza Management Corp. in Bayside for over $3 million. They had a 36-unit apartment building in Village Mall Apartments of over $600,000; the Village Mall at Bayside, 46 two-family homes, for over $1,500,000.

And of course the last one before we got into the act was the Village Mall at Hillcrest.

But again I think that we should point out that the Village Mall Townhouses, Inc. is not a high rise; it is simply a three-story building. So it was not something outside of their normal operations.

Mr. ROSENTHAL. How many of these projects did they have going at one time?

Mr. LIETGEB. The only one that was going on at the time was the Village Mall at Hillcrest and the rental job at the Village Mall itself. Those are the only ones we are aware of.

Mr. ROSENTHAL. Had they also purchased some vacant land in that same vicinity; and, had they used assets that were used in this project for the purchase of that land?

Mr. SHANE. We have no knowledge of how they purchased that property, sir.

Mr. ROSENTHAL. I still would like you to tell us, based on an investigation of a significant loan by your institution, the extent, the evaluation you made of the financial worth, the character, the integrity of these people.

Mr. GRANT. Sir, I would like to make some comments on that because obviously we understand your concern with this issue.

If we read further in that document, there is a list of the various other financial institutions who have done business with these people.

Mr. ROSENTHAL. Two of the principal ones that they did business with were Franklin National Bank and the Security National Bank.

Mr. GRANT. Yes, sir. I would like to read this to give you an example of the kinds of institutions involved. This is published by the New York Times. It is admittedly an advertising brochure, put out by the Rosano and Newmark interests. But the Times doesn't do this kind of thing lightly; they don't deal with fly-by-night people if they have any way of knowing.

Mr. ROSENTHAL. Who doesn't deal with fly-by-night people?

Mr. GRANT. The New York Times.

Mr. ROSENTHAL. How do you know that?

Mr. GRANT. They check on that sort of thing. I am sure that neither of us wants to attack the New York Times——

Mr. ROSENTHAL. Are you a lawyer?

Mr. GRANT. No, sir.

Mr. ROSENTHAL. What is your profession?

Mr. GRANT. I am mainly involved in research and development at the association, and with management. I am the secretary of the corporation.

Mr. ROSENTHAL. Is it your certification that the New York Times investigated the integrity of this matter before they published that?

Mr. GRANT. No, sir. I would not want to pass on that. I think it is more important to read this listing here.

Mr. ROSENTHAL. What was Newmark's profession prior to the association with Rosano?

Mr. GRANT. Could I finish this, sir, before we get into that?

We have here an advertisement which says, "The builders of Village Mall Townhouse came to us with a plan for a resort community in the heart of New York City, something that has never been done before. But they had the right combination of imagination, experience, and innovative building techniques to convince us that they could do it, and that they could rent these luxury apartments for less than luxury prices by a new, faster money-saving building system. But they couldn't do it without our financial help, and we combined our resources to meet their mortgage needs." This is signed by the HNC Realty Investors Corp., which is the Hartford National Bank, as you know; the Bank of America Realty Services, which is Bank of America, the largest bank in this county; the Nassau Trust Co., the Chemical Realty Corp., which is Chemical Bank; Security Mortgage Investors, the Security National Bank which we mentioned; General Electric Credit Corp., a well-known extender of credit; the National Bank of North America.

Now that is just one thing I would like to submit.

Mr. ROSENTHAL. We are going to delve into that at great length. Why did you submit that?

Mr. GRANT. You asked how we go about checking. All of these banks are mentioned——

Mr. ROSENTHAL. Is it your position that you relied upon the integrity of these other financial institutions?

Mr. GRANT. No, sir.

Mr. ROSENTHAL. Did you make an independent investigation in this matter? Tell us exactly what you did.

Mr. GRANT. Yes, sir. That is all spelled out in this paper. We were in the process of reading it. We can continue to read it, if you would like.

Mr. ROSENTHAL. I want you to do that. But HNC was the principal combine that lent these folks $40 million for the high rise at the same place. Isn't that correct?

Mr. GRANT. Yes.

Mr. ROSENTHAL. That loan is in default too.

Mr. GRANT. Yes—as are the loans of hundreds of builders across the country.

Mr. ROSENTHAL. Right. And we are going to try to find out why. Yours is one of the first loans that we are going to exhaustively investigate, including this loan and the nature and operation of your insti-

tution and the supervision. All you have to do is ride down to Florida and you can see how banks did the same thing you did.

Now part of the reason you did it was because you got $170,000 in points. Is that correct?

Mr. GRANT. This was a normally constructed business transaction. Those fees are not unusual.

Mr. ROSENTHAL. Tell me about Mr. Newmark's background.

Mr. LIETGEB. The only information we have on Mr. Newmark is that he was a partner of Newmark and Mitchell, Inc., a Manhattan-based advertising and marketing company.

Mr. ROSENTHAL. He was an advertising agent.

Mr. LIETGEB. Since that partnership was formed, they constructed seven major jobs in and around the Bayside area. This would be a clear indication that they have the capability of doing the job.

We confirmed Mr. Rosano's previous building experience as well as the building experience of the partnership of Rosano & Newmark by inquiries with lending institutions involved. Among such lenders were Security National Bank, HNC Realty, Franklin National, National Bank of North America, Bayside Federal Savings and Loan, and Whitestone Savings and Loan.

Washington Federal also confirmed that the Village Mall at Hillcrest project was under construction and was a little over 80 percent complete, approximately 77 percent of the units had been sold, and $12 million of the $16 million loan had been disbursed.

Mr. ROSENTHAL. Who was the financial agent in the Village Mall at Hillcrest project?

Mr. GRANT. Security National Bank.

Mr. ROSENTHAL. And they went broke.

Mr. LIETGEB. Yes, sir.

Mr. ROSENTHAL. Have any indictments flowed from that Hillcrest project?

Mr. SHANE. On information we read in the papers this morning, Messrs. Newmark & Rosano were indicted yesterday, and surrendered for arraignment in Queens.

Mr. ROSENTHAL. On how many counts?

Mr. SHANE. On 240-odd counts of alleged grand larceny, according to the newspapers.

Mr. ROSENTHAL. Mr. Lietgeb, I know you must be disturbed by this, and that is why I wish you could explain, in a way that would satisfy you, exactly how zealous you were in your investigation of these two fellows.

Mr. LIETGEB. I think we adopted and followed the normal practices that are generally accepted by all lending institutions in looking at their credit reports that are provided for corporations, and to check the presence of any litigation, judgments, et cetera. We were basically lending on a piece of real estate. The real estate is the collateral that supports the money we put out. That is the primary purpose of a construction loan.

We did not make an unsecured loan.

Mr. ROSENTHAL. I think you have hit upon the nub of the case now. How much is that property worth with no construction on it?

Mr. LIETGEB. We have the appraisal here. The appraiser puts a value of $1,700,000 on the land.

Mr. ROSENTHAL. How much did they pay for the property?

Mr. LIETGEB. We don't know.

Mr. ROSENTHAL. The records don't reveal what they paid?

Mr. LIETGEB. It really doesn't make that much difference in the appraisal of the property. Again, the land value is based on the finished product as to what it will sell for.

Mr. ROSENTHAL. It was worth $1,700,000 barren?

Mr. LIETGEB. With the completion of the building. That is the value that the appraiser uses.

Mr. ROSENTHAL. What is it worth today with the buildings half completed?

Mr. LIETGEB. We haven't received a final appraisal, but we understand the overall total will be about $3,200,000.

Mr. ROSENTHAL. Have you been receiving interest on the money you have expended?

Mr. LIETGEB. No, sir.

Mr. ROSENTHAL. How much has this experience cost you to date? How much is the bank out of pocket?

Mr. LIETGEB. Interestwise?

Mr. ROSENTHAL. Anywise?

Mr. SHANE. At this point, the total value of the loan advanced is approximately $2,600,000.

Mr. ROSENTHAL. Of which Bankers Trust has 60 percent.

Mr. SHANE. Of which Bankers Trust has 60 percent. The accrued interest and expenses in connection with this loan as of today are a little bit in excess of an additional $400,000.

Mr. ROSENTHAL. Now I assume they paid you the $170,000 in cash or check.

Mr. LIETGEB. By check; yes, sir.

Mr. ROSENTHAL. From where did they get that money? Do you know?

Mr. SHANE. From the distribution of the mortgage proceeds at the time of the building loan mortgage closing.

Mr. ROSENTHAL. Who provided those funds?

Mr. SHANE. Washington Federal Savings and Loan.

Mr. ROSENTHAL. No—where did they get the funds for the $170,000 finders or points or whatever you call it?

Mr. SHANE. Those are the funds to which you just referred. Those are the costs of closing the loan, where the commitment fee for both the building loan——

Mr. ROSENTHAL. You took that off the $2,600,000? Is that the customary way of doing it?

Mr. SHANE. No, sir. That is included in the total building loan mortgage commitment of $5 million, for the fees, interests, and other expenses of the loan. The estimated actual cost of construction included in that $5 million loan was something less than about $4.5 million. Those are the soft money costs associated with constructing a project.

Mr. ROSENTHAL. So in a sense, they pay themselves back that money.

Mr. SHANE. In the total estimated project cost of $6.5 million are all of the costs and expenses of constructing the project—the brick and mortar plus all of the costs of financing and building the project. That includes legal fees, interests, et cetera.

Mr. ROSENTHAL. Mr. Lietgeb, when you got the credit record which was dated January 29, 1973, it said, "No credit shown on inquiry. We corresponded with subject and tried to contact him at office on several occasions, but to date have received no reply." Isn't that a red light signal to somebody somewhere? Even though this is a $5 job, doesn't it mean something?

Mr. LIETGEB. I don't attach the same significance that you do, apparently. Maybe I don't quite understand your question. But in light of all of the underwriting criteria we have, to pick out just one little single item did not disturb us the way that you feel that it should have.

Mr. ROSENTHAL. As of this morning, does it disturb you?

Mr. LIETGEB. In hindsight, of course we would be very happy if we hadn't made the loan.

Mr. ROSENTHAL. Mr. Brown.

Mr. BROWN. Your colleague said a minute ago that even as of now the information you received, with regard to the financial statement, is still valid.

Mr. LIETGEB. As far as we know, it is. We haven't any evidence to challenge anything in it.

Mr. BROWN. But you said that you would rather not have made the loan.

Mr. LIETGEB. That is hindsight.

Mr. BROWN. But if you were still looking at it, not knowing what you know, you would have made the loan.

Mr. LIETGEB. I would have made the loan; yes, sir.

Mr. BROWN. I trust the chairman is more familiar with loan practices than he appears to be. This is a secured loan.

Mr. LIETGEB. That is correct.

Mr. BROWN. The credit of the individual is really not as significant as the security for the loan. Is that correct?

Mr. LIETGEB. That is absolutely right, Congressman.

Mr. BROWN. So all of the information you developed to determine whether to make the loan was in addition to the security. You were looking more at the security than the borrower.

Mr. LIETGEB. That is correct.

Mr. BROWN. And that is true in almost every case, isn't it?

Mr. LIETGEB. In every real estate loan.

Mr. ROSENTHAL. So you are telling us that the reputation of the builders was not of great significance. The land was worth money. In Bayside at that time, the land was in fact skyrocketing and you felt this was a fairly secure operation.

Mr. LIETGEB. No; I didn't say that the reputation of the builders was not significant because we did check with many, many institutions. All of the reports we got were favorable.

Mr. ROSENTHAL. Tell us some of the checks you made. Do you have any one document that shows you checked with anybody?

Mr. LIETGEB. We have memoranda prepared by members of our staff.

This is a memorandum prepared by the mortgage officer, dated October 18, 1973. You have it in your exhibit, marked 50 and 51.

Mr. ROSENTHAL. Is that Mr. Callicutt?

Mr. LIETGEB. That is correct.

Mr. ROSENTHAL. Tell us what he says about them.

Mr. LIETGEB. Messrs. Rosano and Newmark are presently in construction of three residential projects. The first is a twin 21-story luxury apartment project, known as Bayview Towers. The construction financing has been arranged by the HNC Real Estate Trust and is a $41 million construction loan with no takeout. The project cost will be a little over $42 million and the lender has satisfied itself that the equity money is in the project in front of them in the form of land. The $41 million covers direct construction as well as indirect construction items such as interest on the building loan. The project to date has advanced a little over $10 million on the building loan. The project is active in compliance with the construction lender terms and conditions.

The second project, which is a little over 80 percent complete, is two high rise buildings known as the Hillcrest Condominium on Union Turnpike, off 150th Street, Queens. This project is virtually sold out—77 percent—with firm contracts signed and commitments processed by the lending bank, Security National.

Mr. ROSENTHAL. What is the date of the memorandum?

Mr. LIETGEB. October 18, 1973. It is numbered 50 and 51.

Mr. ROSENTHAL. Did you feel, more or less, in your judgment that the land secured the loan?

Mr. LIETGEB. No; it is the completed project that would secure the investment by Bankers Trust and Washington Federal.

Mr. ROSENTHAL. In that sense, the integrity of the builders would be important in order to determine if they could complete the project.

Mr. LIETGEB. You do check on the experience of the builder. If he has demonstrated what we call a good track record, that is an inducement to go ahead with the project if it is viable and salable.

Mr. ROSENTHAL. In a sense, they mortgaged out on this property, didn't they?

Mr. LIETGEB. If you are referring to that second $41 million mortgage——

Mr. ROSENTHAL. Yes.

Mr. LIETGEB. Let me have counsel explain that.

Mr. SHANE. Congressman, if you are suggesting that the developer had no equity invested in this project, I think that that is completely erroneous if you look at the appraisal value of the property.

We agreed to make a $5 million building loan to this project. On the completion of the project, we had agreed to make end loans to the purchasers. But the estimated cost of completion of the entire project was in excess of $6.5 million. So that $1.5 million, which was the difference between the building loan and the cost of completion, had to be furnished from the pocket of the developers as the project proceeded, and was represented in substantial part by the value of the land which they had acquired previously—out of their own funds, we presume. And it certainly was mortgaged to us free and clear of outside liens. So they obviously had to have an equity investment in this project.

Mr. ROSENTHAL. When did you make the first advance to them?

Mr. SHANE. In October of 1973.

Mr. ROSENTHAL. How much did you advance to them?

Mr. SHANE. We have a schedule of advances, of which you have a copy. The total first advance which was made on November 23, 1973, was $83,000. That was the initial advance.

Mr. ROSENTHAL. October 30, 1973, was the first advance made, wasn't it?

Mr. SHANE. That is right.

Mr. ROSENTHAL. How much was it?

Mr. SHANE. It was $1,016,000.

Mr. ROSENTHAL. What did that represent?

Mr. SHANE. That represented the whole variety of items that were financed at the initial closing, including, without limitation, the cost of the completed work through that date because construction had started well in advance of the closing of the loan.

Mr. ROSENTHAL. Could you tell us how much in that first closing was for land development?

Mr. SHANE. I think I can.

Mr. ROSENTHAL. While he is looking for that, Mr. Lietgeb, to your knowledge is this the first and only condominium project in New York that has gone sour?

Mr. LIETGEB. We know of Hillcrest.

Mr. ROSENTHAL. Outside of Rosano and Newmark, nothing else has gone sour in the entire State.

Mr. LIETGEB. I am not aware of any in New York City.

Mr. ROSENTHAL. Just to restate it for the record, the firm that brought you this project was the firm that Callicutt had previously been employed by, wasn't it?

Mr. SHANE. To clarify, Mr. Congressman, I think Mr. Lietgeb testified before that he had met the mortgage broker who was then doing appraisal work for the Lincoln Bank, by whom Mr. Callicutt was then employed.

The mortgage broker was not employed directly by the bank. He was an outside, independent agent.

Mr. Callicutt had met him in the course of his other duties when Mr. Callicutt was employed by the other bank.

Mr. ROSENTHAL. Have you ever been to Newmark's home at Sands Point?

Mr. LIETGEB. No, sir.

Mr. ROSENTHAL. Have any of your officers or employees been there?

Mr. LIETGEB. I understand Mr. Calicutt went to a barbecue.

Mr. ROSENTHAL. One?

Mr. LIETGEB. That was all that was reported. And it was after the loan was closed.

Mr. BROWN. It seems to me significant that you are here being chastised somewhat for this defunct project. But Bankers Trust had 50-percent more involvement than you did.

Mr. LIETGEB. That is correct.

Mr. BROWN. Now Bankers Trust certainly didn't become involved pro forma on your investigation, did it?

Mr. LIETGEB. No; we understand they made a complete, independent research and have probably more information in their file than we have here.

Mr. BROWN. They agreed to get a 50-percent greater exposure than you have.

Mr. LIETGEB. That is correct.

Mr. ROSENTHAL. Is Bankers Trust suing you?

Mr. LIETGEB. There is a suit, but I will let counsel explain the suit.

Mr. SHANE. Bankers Trust has brought action seeking recision of their participation agreement on the theory that because of an alleged mutual mistake of fact, being the title problem——

Mr. BROWN. But that has nothing to do with the representation of the project or the representation of the builder or the representation of credit.

Mr. LIETGEB. That is correct.

Mr. BROWN. It is basically because there is a title defect.

Mr. LIETGEB. That is correct.

Mr. BROWN. In fact, they are saying that they participated in a project where you represented yourself to have the first lien and the borrower did not have good title, and as a consequence, you do not have a good lien.

Mr. LIETGEB. That is correct.

Mr. BROWN. Until you resolve that title problem, the title company has some exposure there.

Mr. LIETGEB. They are at the present time, as Congressman Rosenthal knows, working out some difficulties with the subcontractors, et cetera.

Mr. ROSENTHAL. Do you have a copy of the complaint that Bankers Trust served on you?

Mr. SHANE. We do not have one with us.

Mr. ROSENTHAL. Will you send us a copy?

Mr. SHANE. Certainly.

[The information referred to follows:]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

- x

BANKERS TRUST COMPANY,

Plaintiff,

-against-

WASHINGTON FEDERAL SAVINGS AND LOAN ASSOCIATION,

Defendant.

VERIFIED COMPLAINT

- x

Plaintiff, by MOSES & SINGER, its attorneys, for its verified complaint, alleges as follows:

1. At all times hereinafter mentioned plaintiff was and still is a domestic banking corporation with its principal place of business being located in the City, County and State of New York.

2. Upon information and belief, at all times hereinafter mentioned, defendant was and still is a banking corporation organized and existing under the laws of the United States of America, with an office for the transaction of business at 1390 St. Nicholas Avenue, New York, New York.

3. On or about October 30, 1973 defendant entered into a building loan agreement (the "Building Loan Agreement") with Village Mall Town Houses, Inc. ("Village Mall") for the purpose of financing the construction of condominum housing structures, pursuant to which Village Mall executed and delivered to defendant a promissory note dated October 30, 1973 (the "Promissory Note") in which it promised to pay to defendant the principal sum of $5,000,000 or so much as may be advanced to it by defendant no later than eighteen months from the date of said Promissory Note, together with interest thereon until paid at the rate of 2-1/2% above the prime rate fixed by Chemical Bank, adjusted monthly. The prime rate fixed by Chemical Bank, adjusted monthly, for the period in question is as specified in Exhibit "A" annexed hereto. The Promissory Note further provided that in case of default in the Promissory Note or Mortgage, interest during the period of such continued default is chargeable thereupon at the rate of 2% per annum in excess of the rate charged in the Promissory Note as aforesaid.

4. On or about October 30, 1973, pursuant to the Building Loan Agreement defendant caused Village Mall to execute and deliver to defendant a mortgage (the "Mortgage") with respect to the land and the buildings to be erected thereon (the "Premises") as security for payment of the Promissory Note.

5. Among other things, the Building Loan Agreement provided that the Mortgage:

> " ... is to ... be ... a First Mortgage covering said premises, duly executed and acknowledged by all persons necessary to make it a valid First lien on a good and marketable title in fee to said premises for all sums that may be advanced on said bond and mortgage, free and clear of all encumbrances except as may be waived by the Lender."

6. On information and belief, the Mortgage was recorded in the Office of the Register of the City of New York, County of Queens, on November 2, 1973.

7. On information and belief, defendant made advances to Village Mall, pursuant to the Building Loan Agreement totalling $1,099,000 at or before November 27, 1973 and totalling $1,431,000 at or before January 14, 1974.

8. Pursuant to a Participation Agreement dated November 27, 1973 with defendant (the "Participation Agreement"), plaintiff agreed to purchase from defendant a 60% interest in said purported secured building loan. On January 15, 1975 and from time to time thereafter as set forth below, plaintiff purchased from the defendant for the aggregate sum of $1,568,000 a 60% interest in the said purported secured building loan made by defendant to Village Mall, including such advances made by defendant pursuant thereto prior to January 15, 1974 as alleged in paragraph 7 above:

DATE	AMOUNT OF PLAINTIFF'S PURCHASE
January 15, 1974	$ 858,000
February 7, 1974	62,400
March 20, 1974	49,800
April 8, 1974	64,000
April 17, 1974	30,000
May 10, 1974	135,200
June 12, 1974	162,000
July 9, 1974	136,800
August 6, 1974	69,600
	$ 1,568,400

9. Prior to the execution and delivery of the Participation Agreement, defendant represented to plaintiff that Village Mall had a good and marketable title in fee to the Premises and that the Mortgage was and would be during the term of said building loan a valid and enforceable first lien on

the Premises, subject to no other lien, charge or encumbrance.

10. On information and belief, Village Mall did not have good and marketable title in fee to the Premises at any of the times aforementioned, including, when the Building Loan Agreement was entered into, when the Mortgage was executed, delivered and recorded, when the Participation Agreement was entered into or at any time thereafter up to and including the date hereof.

11. On information and belief, during all of the times mentioned in paragraph 10 above, Village Mall was not the owner of an estate in fee in and to the Premises and no conveyance the Premises to or in the name of Village Mall had been executed, acknowledged and recorded in the manner provided under Article 9 of the Real Property Law of the State of New York for recording of instruments affecting real property.

12. On information and belief, the Mortgage is not a valid and enforceable first lien, or a lien, on the Premises.

13. The representations made by defendant to plaintiff set forth in paragraph 9 above were false and were made under the mistaken assumption and belief of defendant that they were true.

14. Said representations made by defendant to plaintiff

set forth in paragraph 9 above were material and basic to the Participation Agreement, and plaintiff relied upon said representations and assumed and believed them to be true and as a result thereof was induced to and did enter into the Participation Agreement and purchase the aforesaid interest in defendant's rights in the said purported secured building loan.

15. As a result of the foregoing, plaintiff and defendant entered into the Participation Agreement under the mutual mistake of fact, basic to the Participation Agreement, that Village Mall had a good and marketable title in fee to the Premises and that the Mortgage was and would be a valid and enforceable first lien on the Premises.

16. Promptly upon discovering the facts set forth in paragraphs 10, 11 and 12 above, plaintiff formally notified the defendant in writing that plaintiff elected to rescind the Participation Agreement and its purchase thereunder of the aforesaid interest in said purported secured building loan and (a) demanded that defendant return and restore to plaintiff the payments made by plaintiff to defendant pursuant to the Participation Agreement aggregating $1,568,400 and interest as specified in paragraph 3 above and as provided by law, compensating plaintiff for its loss of the use of such monies, (b) subject to reduction or offset by the sum of $120,520.87, representing plaintiff's portion of the

commitment fee and interest on said building loan received by defendant from Village Mall pursuant to the Building Loan Agreement.

17. Defendant has failed, neglected and refused to restore to plaintiff the sums set forth in paragraph 16 above.

18. At all such times plaintiff has been and still is ready, willing and able and hereby offers to return to defendant the sums set forth in clause (b) of paragraph 16 above and any other things of value received by plantiff from defendant, upon receiving from defendant of the sums set forth in clause (a) of paragraph 16 above.

WHEREFORE, the plaintiff requests judgment as follows:

1. That the Participation Agreement be wholly rescinded and cancelled.

2. That plaintiff have judgment against the defendant for $1,568,400 together with interest as specified in the complaint but giving credit to defendant for the sum of $120,520.87 received by plaintiff as alleged in the complaint.

3. That plaintiff may have such other and further relief as to this Court may seem just and proper, together with the costs and disbursements of this action.

MOSES & SINGER
Attorneys for Plaintiff
Office and P.O. Address:
51 West 51st Street
New York, New York 10019
Tel: (212) 581-9000

PRIME RATE OF INTEREST
CHARGED BY CHEMICAL BANK

The following schedule reflects the prime rate of interest charged by Chemical Bank as of January 31, 1974 and as adjusted as of the last day of each month during which a change occurred in such rate, up to and including the day of the complaint:

Month	Percentage Rate
January 31, 1974	9.5
February 28, 1974	8.75
March 31, 1974	9.25
April 30, 1974	10.5
May 31, 1974	11.5
June 30, 1974	11.75
July 31, 1974 through September 30, 1974	12.0
October 31, 1974	11.25
November 30, 1974 through December 31, 1974	10.5
January 31, 1975	9.5
February 28, 1975	8.5
March 31, 1975 through April 30, 1975	7.5
May 31, 1975	7.25
June 30, 1975	7.0
Day of the Complaint	7.25

EXHIBIT A

STATE OF NEW YORK)
: ss.:
COUNTY OF [redacted] NASSAU)

LOWELL R. RABINOWITZ, being duly sworn, deposes and says that he is an Assistant Vice President of Bankers Trust Company, a New York banking corporation, the plaintiff corporation named in the within entitled action; that he has read the foregoing complaint and knows the contents thereof, and the same is true to his knowledge, except as to the matters therein stated to be alleged upon information and belief, and as to those matters he believes it to be true.

Lowell R. Rabinowitz

Sworn to before me this
23 day of July , 1975

Janet E. Amriati
Notary

JANET E. AMRIATI
NOTARY PUBLIC, State of New York
No. 30-4603993
Qualified in Nassau County
Certificate filed in New York County
Commission expires March 30, 1976

Mr. ROSENTHAL. I am interested in knowing what amount was advanced at the first closing and how much was attributable to land cost development.

Mr. SHANE. The checks that were disbursed at the closing from mortgage proceeds were to three parties, sir. They were to Security Title—$72,000—which I am sure represented the mortgage recording tax, the charge for recording the deed.

Mr. ROSENTHAL. I am interested really in what went to Newmark and Rosano.

Mr. SHANE. The first advance to Village Mall Townhouses, Inc., was the sum of $794,728, which, I am sure, represented the disbursement to them of the portion of the loan which was due at that time, based upon construction which had taken place to that time.

Mr. ROSENTHAL. How much did they pay for the land? Do you know?

Mr. SHANE. No; I do not.

Mr. ROSENTHAL. Is there anything in your records to indicate that?

Mr. SHANE. No.

Mr. ROSENTHAL. Have you ever checked the deed of purchase to find out how much they paid? Or does that not mean anything?

Mr. SHANE. No; it really doesn't mean anything in the normal approach to one of these loans. At the time they acquired it, they improved it; they made applications for zoning changes; they did all kinds of site work. Also, the value of the land for the project was reflected in the appraisal report which we got. We don't care what they paid for it.

Mr. ROSENTHAL. Did they get their money out of it at the time of this first payment?

Mr. SHANE. We don't know; nor, did we care.

Mr. ROSENTHAL. You really don't care. Well you would care because at that point they had nothing more invested in that property.

Mr. SHANE. That is not so.

Mr. ROSENTHAL. What did they have invested in it?

Mr. SHANE. The difference between our building loan mortgage and the cost of completing the project.

Mr. ROSENTHAL. But they were going to get additional payouts from you to continue the construction.

Mr. SHANE. We were going to advance the total sum of $5 million on a percentage-of-completion basis. At no time would they ever be ahead of the percentage of completion in terms of our advances.

If they drew down 100 percent of the loan, they would have $5 million. When 100 percent of the project was completed, based upon our advice from our experts, the total project would have cost in excess of $6.5 million. That difference of $1.5 million had to come from someone's pocket.

Mr. ROSENTHAL. The fact is that it came from some other project.

Mr. SHANE. We don't know that.

Mr. ROSENTHAL. What do you think?

Mr. SHANE. I don't know. I do know that they used the depositors' money, the contract vendees' money, in constructing the project. And the difference that they were ultimately going to get had to come out of the purchase price.

Mr. ROSENTHAL. The fact is that they used the purchasers' $600,000.

Mr. SHANE. I presume so.

Mr. ROSENTHAL. And you don't feel any responsibility for that?

Mr. SHANE. Sir, we are a lending institution, not a police agency.

Mr. ROSENTHAL. But all of these people came down there and knew that Washington Federal was certifying that it was, in a sense, behind this project.

Mr. SHANE. Never so.

Mr. ROSENTHAL. You don't think so?

Mr. SHANE. Washington Federal never certified that it was behind the project.

Mr. ROSENTHAL. You just told us that you investigated Newmark and Rosano and that you were satisfied with their integrity and performance. Is that true?

Mr. SHANE. We were satisfied with their capability as constructors and developers in order to complete the project, and in terms of their general standing in the financial community, with which we checked very specifically with all of the financial institutions in town. Most of them who were doing business with these gentlemen were very substantial. They had an unblemished record.

Mr. ROSENTHAL. Where do you have any correspondence to that effect?

Mr. SHANE. We have the memos in our file indicating that.

Mr. ROSENTHAL. You have self-written memos. Do you have any letter from any bank that says that these are first-rate people?

Mr. SHANE. That is not the way the business is done.

Mr. ROSENTHAL. How is the business done?

Mr. SHANE. The chief mortgage officer of one institution calls the chief mortgage officer of another institution and asks him, "What are you doing with these guys?"

And he tells him. At that time they had several ongoing projects. They appeared to be on the crest of a successful wave in their building program. They had the Hillcrest project.

Mr. ROSENTHAL. They were doing the same number on the other banks that they were doing on you people. Right?

Mr. SHANE. That may be so, Congressman. But to the best of our ability to investigate their capabilities and their standing in the community, they appeared to be outstanding citizens.

Mr. ROSENTHAL. In simple language, what did you do to investigate their capabilities?

Mr. SHANE. We looked at the projects they had completed.

Mr. ROSENTHAL. Your friend over there says he relied on this nicely prepared brochure in the New York Times.

Mr. GRANT. I have to take exception to that, sir. That is not what I said. I merely offered that as additional evidence that there were many responsible organizations in the country who were willing to, on the public record, demonstrate their support for these operators.

And I fail to see that, just because a builder went broke or ran into difficulty, it is necessarily so that prior to his getting into difficulty he was a crook.

There are plenty of reasons and plenty of fine outstanding developers who are in great difficulty at this time. I think this is one of them.

But I merely presented the advertisement as additional evidence of the types of people who were, in fact, supporting this organization.

Mr. ROSENTHAL. Of the types of people who were supporting them, for example, six of them from the Franklin National Bank turned themselves in yesterday to a U.S. marshal for custody. Isn't that correct?

Mr. SHANE. That is true, but they were in the foreign exchange department. Are you suggesting that they had anything to do with the real estate lending in Queens?

Mr. ROSENTHAL. Absolutely nothing. But I am just trying to find out from you whether Newmark and Rosano mortgaged out on this property and had nothing invested in it. Your assertion is that they still had something invested in it.

Mr. SHANE. They had to have something invested in it. Our appraisals, which are the basis of our lending, the cornerstone of our lending, assuming the capability of the developers and the financial capability to do the job were quite sufficient to support the loan that we made.

Mr. ROSENTHAL. Let's get into the specific area of your responsibility. Did your mortgage agreement or contract with them say that, before any disbursement could be made, all permits—city, State, municipal—had to be in order and on hand?

Mr. SHANE. Yes.

Mr. ROSENTHAL. Did they have a sewer permit before you made this payout?

Mr. SHANE. I think you misunderstand the operation of the buildings department of New York. There is no such thing as a sewer permit. There is such a thing as a building permit. That building permit, without further ado, will give you, unless there is a qualification in that building permit, access to the city sewer system.

And Village Mall Townhouses, Inc., did at all times have access to the city sewer system that existed in the bed of 26th Avenue.

Mr. ROSENTHAL. Did they have a building permit?

Mr. SHANE. Yes, sir.

Mr. ROSENTHAL. Do you have a copy of that?

Mr. SHANE. Yes.

Mr. ROSENTHAL. Could you show it to us?

Mr. SHANE. Yes, sir.

Mr. ROSENTHAL. Was that obtained by Merritt & Harris?

Mr. SHANE. Copies of the permit were obtained for us by Merritt & Harris. A copy of this building permit was exhibited at the initial mortgage closing.

Mr. ROSENTHAL. Who is Merritt & Harris?

Mr. SHANE. Merritt & Harris is our independent engineer.

Mr. ROSENTHAL. Does the city of New York give a building permit even if some elements are not yet completed, for which permits have not been issued?

Perhaps you could explain this to us. You are quite right in that I do not understand. One of the reasons this project seemed to have gotten into difficulty was the inability to hook into the sewer system.

Mr. SHANE. That is not correct.

Mr. ROSENTHAL. Tell us what you know about it.

Mr. SHANE. If you will look at the attachment to our statement which deals with the sewer easement situation, I tried to make it clear in writing. But let me try and explain it.

As part of the overall project, it was necessary for the developers to close the bed of 210th Street, which ran through the project from 26th to 29th. As a condition to the closing of 210th Street, the city, as is typical with projects of like type, required an execution of the street closing agreement. That street closing agreement, which was ultimately executed on the date of July 17, 1973, between the city of New York and the developers, required the developer to dedicate an easement to the city along the bed of the sewerline in former 210th Street which ran through the high rise project and out into 26th Avenue.

That easement, which was 30 feet wide, ran under a portion of building No. 3. The townhouses at all times had the right to hook up to the sewer system in 26th Avenue. There was never any question of the adequacy of that sewer.

Mr. ROSENTHAL. Fine. And on March 8, 1974, did Merritt & Harris recommend that advances be suspended pending clarification of the sewer situation?

Mr. SHANE. Yes, for a period of 10 days. They wrote back that on further investigation they rescinded that and were quite willing to approve further advances.

Mr. ROSENTHAL. Did you make the advances during the period of time when they said advances shouldn't be made?

Mr. SHANE. No.

Mr. ROSENTHAL. When they told you advances shouldn't be made, was that another warning signal here?

Mr. SHANE. It was a signal of a problem that existed at that time. And we asked them to investigate further, which they did.

Mr. ROSENTHAL. What did they do?

Mr. SHANE. They submitted a subsequent report.

Mr. ROSENTHAL. Do you have a copy of that report?

Mr. SHANE. Yes, we do.

Mr. ROSENTHAL. Would you show it to us?

Mr. SHANE. The first thing I would like to give you is a copy of a letter on the date of March 12, 1974, addressed to Mr. Toth who was at Merritt & Harris, and from Village Mall Properties. It explains their problems in connection with the sewer situation.

[The letter referred to was not submitted.]

Mr. ROSENTHAL. As of today, has this matter been resolved?

Mr. SHANE. As far as Village Mall Townhouses, Inc., is concerned.

Mr. ROSENTHAL. Have all the necessary permits been obtained?

Mr. SHANE. Yes, sir.

Mr. ROSENTHAL. Where is the letter from Merritt & Harris which clears up this matter and suggesting that you should discontinue the payouts?

Mr. SHANE. Let me find that letter.

[The material referred to follows:]

MERRITT & HARRIS, INC.
CONSTRUCTION CONSULTANTS
REAL ESTATE APPRAISALS

EAST FORSYTH STREET
JACKSONVILLE, FLA. 32202
(904) 356-6641

110 EAST 42ND STREET
NEW YORK, N. Y. 10017
(212) 697-3185

RACQUET CLUB CONDOMINIUM
SAN JUAN, PUERTO RICO 00630
(809) 791-4970

#12-455

March 8, 1974

Washington Federal Savings & Loan Association
1390 St. Nicholas Avenue
New York, New York 10033

Attention: Mr. Morris H. Steiner, Assistant Mortgage Officer

Re: Village Mall Townhouses
Bayside, Long Island, New York

Gentlemen:

An inspection of the above project on March 1, 1974 showed construction progress to be as follows:

- Concrete plank is complete on the 1st floor in Buildings 1, 2 and 4, and substantially complete in Building 3.
- Basement level masonry is complete in Buildings 1, 2 and 4, and substantially complete in Building 3.
- Masonry is partially complete and in progress on the 1st floor in Building 1.
- Window frames at the basement level are substantially complete in Building 1 and partially complete in Building 2.

The developer has apparently not yet obtained final approval from the Building Department for the new storm and sanitary sewer systems for the project and the existing sewer relocation although a building permit has already been issued.

These systems are being treated as an overall package for the Townhouses and the Village Mall Tower project on the adjacent site. The design engineer for this work is Mr. Manuel Elken although we have received no plans prepared by him for review. The approval of this work effects the entire Townhouse project. We have had considerable difficulty in obtaining information on this matter and we request your assistance in obtaining the complete details from the developer. In addition, for your information, we note that work has apprently been suspended on one of the Tower buildings.

The job is active.

We would recommend that advances be suspended pending clarification of this situation.

MAR 11 1974

W F S & L A

MERRITT & HARRIS, INC.

#12-455

March 8, 1974

For your information, we estimate the project to be 18.5% complete excluding Building #3.

Very truly yours,

MERRITT & HARRIS, INC.

By: Roger Maynard

Roger Maynard
President

PH:hp

cc: Bankers Trust Co.
Attn: Mr. William R. Wright, Vice President
Mr. Paul Halstead

MERRITT & HARRIS, INC.
CONSTRUCTION CONSULTANTS
REAL ESTATE APPRAISALS

O EAST FORSYTH STREET
CKSONVILLE, FLA. 32202
(904) 356-6541

110 EAST 42nd STREET
NEW YORK, N. Y. 10017
(212) 697-3188

RACQUET CLUB CONDOMINIUM
SAN JUAN, PUERTO RICO 00630
(809) 791-4970

#12-455

March 13, 1974

Washington Federal Savings & Loan Association
1390 St. Nicholas Avenue
New York, New York 10033

Attention: Mr. Morris H. Steiner, Assistant Mortgage Officer

Re: Village Mall Townhouses
Bayside, Long Island, New York

Gentlemen:

We have been informed by Mr. Michael Newmark of Village Mall Properties that approval of the storm and sanitary sewer systems for the above project will be forthcoming shortly. He indicated that they have been actively working with the Building Department and the Department of Water Resources to provide systems which would be acceptable to these agencies. Mr. Newmark is to send a letter summarizing these activities and any proposals which have transpirad. He will also forward the latest plans available as prepared by the engineer for this work, Manuel Elken, and final plans and specifications when they are available.

Based on our estimate of completion of the project of 18.5% and the direct construction cost of $4,150,000, the following advance is in order:

Previous Amount Approved Advances	Current Amount Approved Advance	Total Amount Approved Advances
$685,000	$83,000	$768,000

Please note that no credit for Building #3 is included in the above percentage in accordance with your instructions.

We have not as yet received a satisfactory response to comments 1, 2, 3, 5 and 7 contained in our letter of October 15, 1973, nor the engineer's report requested pertaining to the low concrete test reports - Reports N1 and N2. The engineer's report on concrete tests should also include test N21.

Very truly yours,

MERRITT & HARRIS, INC.

By
Stephen F. Toth

SFT:hp

cc: Mr. Paul Halstead

DRAFT
RLC:nr 3/12/74

Mr. William R. Wright

Bankers Trust Company

Dear Mr. Wright:

I would like to make some comments concerning the Merritt & Harris inspection report dated March 8 in which they recommend that advances be suspended pending clarification of the sewer hook-up.

At the time the loan was closed there was a question concerning the final approval for hooking up to the sewer system. The problem was circumvented by not advancing any monies on Building No. 3 until they had their final approval. As of today, they still do not have the final approval. However, Mr. Newmark has recently submitted a plan which the City of New York has suggested to me. Inasmuch as Merritt & Harris had not received the current plan on the sewer system, they recommended that advances be suspended until they received this information. Mr. Newmark assured me yesterday that Merritt & Harris shall receive the new plan and final approval shall be received in sixty days. After reviewing this matter I believe that our loan would not be jeopardized since Buildings No. 1, 2 and 4 may hook up to the sewer system which passes in front of the property. I will follow up with Merritt & Harris to make sure they receive the information they require before the next advance is made.

Very truly yours,

Mr. BROWN. Is the city of New York satisfied that there is no sewer problem?

Mr. SHANE. Yes. Let me explain at some length because there has been a lot of confusion about that particular question.

As part of the high rise, the developers had entered into an agreement with the city to do a sewer system which required pumping their sewage out through the bed of former 210th Street out into 29th and then up to a sewage pumping station which was established by the city, based upon original design criteria.

That was at a time when the townhouses project did not exist within the contemplation of the developers. When, during the ensuing months, the townhouses project was developed back in 1971 and 1972, the design criteria for that pumping station, which had already been established by the city, were felt by the city engineers involved to be no longer valid. They did not feel that that pumping station could take the output of the combined high rise and townhouse project. Another solution had to be found.

During that period, the engineers for the developers, in consultation with the engineers for the city, worked out an alternative solution. The alternative solution had the approval of the specific departments of the city, but had not reached the level of being incorporated in a final agreement by the legislative body of the city of New York, which is the board of estimate.

That solution, as bizarre as it may sound, was to reverse the flow of the sewage, establish a pumping station on the site, pump it instead in the other direction out into 26th, across 26th, across the Clearview Expressway, and dump it into the then relatively unused sewer on the other side of the Clearview Expressway, from which it could be taken away.

This particular plan had to have the approval of not only the department of water resources, which has control of the sewer system, but also had to have the approval of the department of highways because they were dealing in the city street system, the borough president's office because he is involved as the man who officially establishes the grades of all streets and is in charge of those things, and, not least of all, since they were crossing an interstate highway, the Clearview Expressway, they also had to get the approval of the State department of highways, and ultimately the Federal people involved had to approve because of the Federal highway involvement.

Believe me when I say that the bureaucratic snarl that they were involved in to try and untangle this mess was quite extensive and took a long time.

But every step of the way they had letter approvals and indications from the people they checked with that they were proceeding nicely. Everybody agreed that this was going to be an ultimate solution. And only when the corporation council got around to writing an agreement with the necessary bonds and it got on the calendar of the board of estimate for final approval would it all be accomplished. And everything was going along swimmingly.

As far as anybody could tell, this was a fait accompli requiring only the passage of time to do the ministerial details to have it accomplished. And it was proceeding.

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In fact, when we checked—and we have memorandums in our files in August of 1974, when the project was coming to a halt and we had problems and this became an obvious situation that we were terribly concerned about—we called Commissioner Samowitz in the department of water resources and he confirmed that there was no problem. And it was going to be on the board of estimate calendar for resolution.

Notwithstanding all of that, after the project was stopped, with the help of the attorney general of the State of New York who was similarly concerned with this particular problem, we got the department of water resources to waive their position with respect to the easement as contained in the original agreement of July 1973, and that Village Mall Townhouses had every right to build building No. 3, to hook up to the sewers in the existing 26th Avenue. This was without a problem.

The whole issue is moot. It never was a problem as far as the townhouses were concerned. It was obviously a terrible, technical, bureaucratic snarl. But we never had a problem with respect to our loan as to connections to sewers. We did not then; we did not during the course of the construction; we do not now. We have every right to go forward and build this project and connect up to the existing city sewer system.

Mr. ROSENTHAL. Then I don't understand why Merritt and Harris told you not to make any payouts.

Mr. SHANE. Because the easement that was granted to the city of New York by the developers, which ran under building No. 3, by its terms as recorded during the summer of July 1973, said that no structures may be erected on top of this easement—which is why building No. 3 was built only to the edge of that easement. Albeit, we did not advance any funds in connection with building No. 3.

The developers, realizing that they had a problem, were working this whole thing out. And they were reversing the flow of sewage and they were getting the permission to cross the Clearview Expressway and building their own pumping station and doing all of these things. And the city departments had cooperated and had approved it step by step.

Mr. ROSENTHAL. To sum it up, the sewer thing was not a problem.

Mr. SHANE. Absolutely.

Mr. ROSENTHAL. This project was sold out in 2 weekends, wasn't it?

Mr. SHANE. Essentially, yes.

Mr. ROSENTHAL. So what went wrong?

Mr. SHANE. What went wrong was that during the summer of 1974, the inflation of this country caused the construction costs to be going up at the rate of 1 or 1½ percent a month. The credit crunch happened at the same time—in part because of the fuel oil problem and the problem of importing oil from the Middle East. The prime rate went from perhaps 5 or 6 percent to 12 percent and the builder was paying 2 points over prime on his various building loans on the projects he had. And his estimates of costs in development were just badly understated as a result of conditions which we believe were beyond his control since we could not foresee them under any circumstances either.

Mr. ROSENTHAL. Was it possibly because these particular builders were so overextended at the time you made your loan?

Mr. SHANE. I don't believe, from my personal opinion, that they were overextended at the time they made the loan. They were involved

in a lot of projects; they were very successful and doing very well. But the fact is, as events turned out, they were overextended because the conditions ate up their available capital. They had an alleged net worth that was very substantial.

Mr. ROSENTHAL. An alleged net worth—but there was never any verification by your people of their net worth.

Mr. SHANE. We did not go into their bank vault and count their money. We relied on their financial statement. But more importantly, we relied upon their ongoing experience and their ability to meet their obligations at the time as represented by the various banks that they were dealing with.

Mr. ROSENTHAL. What do you think about that, Mr. Lietgeb?

Mr. LIETGEB. That is exactly right. I am glad that counsel expressed it so well. It does point out the position of the association.

Mr. ROSENTHAL. Have you had any other construction loans go sour in the last 3 or 4 years?

Mr. LIETGEB. Not to my knowledge; no.

Mr. ROSENTHAL. So the inflationary trends and the interest crunch and the Middle East conflagrations, et cetera, have not affected any of your other loans. This is the only one.

Mr. LIETGEB. That is correct.

Mr. ROSENTHAL. Doesn't that say something? I cannot fathom that all of these other factors did not affect anything else you did, but only this one.

Mr. LIETGEB. There are many major corporations that have gone into bankruptcy over the years too. And no one knows why some did and others didn't.

Mr. ROSENTHAL. The only major corporations that have gone into bankruptcy are those listed in the New York Times article—Franklin National Bank, Security National Bank, HNC, and so forth.

Mr. LIETGEB. We were talking about business corporations.

Mr. ROSENTHAL. But that is the point I am trying to get at. The Middle East oil affected no other loan in your portfolio except this one.

Mr. LIETGEB. I don't know of any evidence that we had or that we could have had in our investigation of this loan that would lead us to believe that somewhere—1 year or 2 years down the road—that this gentleman or this group would go bankrupt.

Mr. ROSENTHAL. Are you satisfied that your investigation and preliminary planning for this loan was adequate and prudent?

Mr. LIETGEB. Yes, sir.

Mr. ROSENTHAL. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Mr. Lietgeb, you said in answer to the chairman's question that all of your borrowers are in as good a shape today as they were 2 years ago. I don't think you mean "Yes" to that, do you?

Mr. LIETGEB. I am not clear on the question, Congressman.

Mr. BROWN. The chairman was saying that inflation and all of these factors have had no impact on anybody other than this one loan, and you tended to agree with that. You may not have any that have gone bad and had to be written off.

Mr. LIETGEB. That is correct. I have no way of knowing the status of the borrowers who are keeping their loans current.

Mr. BROWN. But anyone in the construction industry is having a little more trouble doing things today, but during that period in 1974, all of them were having a harder time, were they not?

Mr. LIETGEB. That is correct. I think, again, we are only talking about construction loans per se.

Mr. BROWN. But even with respect to construction loans at that time, all of them were having difficulty.

Mr. LIETGEB. Yes, sir; very much so.

Mr. BROWN. I think an attempt to tie in downpayments to the functioning of your institution is wrong. But, for the record, to whom were these downpayments made?

Mr. LIETGEB. According to the offering plan, they were turned over to a group of attorneys who were to act as trustees.

Mr. BROWN. What did they do with them?

Mr. SHANE. Counsel for the developers held those moneys in trust in a bank account until such time as certification was made to them by an officer of the corporation that they were needed and to be used in connection with the development of the project. Upon those circumstances, their escrow obligation was satisfied, as set forth in the offering plan, as accepted for filing by the attorney general of the State of New York. And those moneys were released to the developer and presumably used in the construction of the project. I don't know whether you can trace any particular dollars.

Mr. BROWN. Under New York law, payment of those downpayments to a firm of attorneys was really payment to the developers.

Mr. SHANE. No; they were being held in escrow, subject to the condition that they had to be used in connection with the project. Now the determination of "used in connection with the project" was the certification that those dollars were going into the project. And those attorneys were then authorized to release them from the escrow.

Mr. BROWN. This isn't much protection, you would probably agree, as far as the downpayments.

Mr. SHANE. It depends upon the integrity of the developer. Let us assume that the dollars were in fact used in the development. It would not alter the present situation one whit that those dollars have effectively been lost to those condominium purchasers because of events which swept over these builders and this particular project.

Mr. BROWN. I quite agree.

Mr. SHANE. Nobody has alleged that they stole those dollars. If we assume, and we have no reason to assume the contrary, that they used those dollars and our building loan funds in connection with this project, the same situation exists.

Mr. BROWN. I quite agree. I was looking from the standpoint of anyone who made the downpayment as to whether or not that person could feel that he had some kind of protection with respect to his downpayment. And of course under New York law, he really doesn't so long as the funds are used for the project.

Mr. SHANE. He only had real protection until the time that the building loan mortgage closed; at which time the conditions of the escrow became effective, to wit, that they could be released upon the certification that they were being used in connection with the construction of the project.

Mr. BROWN. What are your chances of yet being able to salvage this project?

Mr. SHANE. We are involved in a very complex litigation at this point. We hope that as a result of the litigation strategy now being pursued that we will be able to bring all of the parties before the court sometime from the middle of April to the middle of May—whenever we can accomplish it.

We will be prepared to file a note of issue sometime around the middle of April. This will cause the matter to be placed on the calendar of the court. By asking for a conference with the judge to whom the matter is assigned, we would hope to get all of the parties inside the court and lock the doors and hope that we could work out something to the benefit of all concerned.

If the parties do not all succumb to that particular kind of pressure, we will be many months, if not actually years, in litigating out the issues that are involved in this case. It has novel questions of law which have been presented nowhere else in this country, as far as we can tell.

Therefore, we are going to have ourselves a very extensive litigation. We would hope that that can be avoided. We believe that the pressure from the bench, as well as the pragmatic pressure from whatever other sources are available, will cause the parties to be reasonable. But we are only one party to this litigation.

So the answer to that is that we have a lot of hope. We have discussed the matter with the developers; we have discussed it with our co-participant; we have discussed it with the contract vendees; we have discussed it with the title company—all of whom are involved in this particular matter. And everybody has not yet approached a common understanding.

If we can get everybody to sit down, we believe that there is still today economic viability to the project. But people are going to have to accept positions less than 100 cents on the dollar, and they are going to have to accept subordination of position until the whole thing can be worked out. We can hope then for an economically successful project.

Our estimate is that we would have to sell the project for somewhere between $8 million and $8.5 million in order to allow all of the interests of the parties to be reasonably accommodated.

Mr. BROWN. With the inflation that has occurred, you would probably inflate your end value anyway, wouldn't you?

Mr. SHANE. We have secured an appraisal, as referred to before by Mr. Lietgeb, which indicates that the present market value of condominia on this site, taking into account all of the other things that are happening, including the noncompletion of the high rise, would allow a reasonable sales price in the area of $8 million. That is the most that the appraiser at the moment is willing to say that we should reasonably project our work out on.

Mr. BROWN. In the course of these hearings, we initially talked to the regulators. That was the jurisdictional basis for our getting into this matter.

Was there anything in connection with the way in which the regulators supervised or examined your institution which you feel contributed in any way to the problem that occurred?

Mr. LIETGEB. No, sir.

Mr. BROWN. I have no further questions.

Mr. ROSENTHAL. We thank you all very much for coming down here. Our next witness is from Merritt & Harris.

What is your name and address, and with whom are you associated?

STATEMENT OF STEPHEN TOTH OF MERRITT & HARRIS, INC.

Mr. TOTH. My name is Stephen Toth. I am employed by Merritt & Harris, Inc.

Mr. ROSENTHAL. What is Merritt & Harris?

Mr. TOTH. We are construction consultants and real estate appraisers.

Mr. ROSENTHAL. Did you bring with you some records concerning the Village Mall Townhouses project?

Mr. TOTH. I brought some limited documents from our files.

Mr. ROSENTHAL. Are you familiar with this project?

Mr. TOTH. Yes.

Mr. ROSENTHAL. Can you do anything to enlighten us as to the sewer problem and the Merritt & Harris letter suggesting to the bank that they hold up on payments and so forth? Tell us what you know about the project.

Mr. TOTH. We were involved in inspecting the project during construction.

Mr. ROSENTHAL. By whom were you employed to do this?

Mr. TOTH. Washington Federal.

Mr. ROSENTHAL. In what role?

Mr. TOTH. As supervisory engineers.

Mr. ROSENTHAL. Go ahead and tell us the rest of it.

Mr. TOTH. We were supervising construction, which meant that we would inspect the project on a monthly basis and that each inspection would determine the amount of work completed in order to certify to the amount of work that was completed for disbursements to be made by Washington Federal so that their disbursement for the construction, the direct cost portion, would not exceed the work in place.

At the time of our inspections, we became aware that there was some problem with sewer connections due to incorporation of the tower project with the townhouses. We were not at all involved in the tower project during the course of our work.

We have no details on what was involved in that project. We were only involved in the townhouse project.

During our inspections, our field inspector became aware of some kind of problem with getting the sewers connected because the towers had become combined with the townhouses in the overall sewer scheme.

We tried to obtain some information from the developer on what the situation was and what the status of working out this difficulty was. We had tried for 2 or 3 months, requesting updated drawings and approvals on this new system. We had not been able to get it.

So in that letter in March 1974, we indicated that we had been unsuccessful in getting any information and in getting to the crux of the problem. And because we couldn't get this information and to put pressure on the borrower to get this to us, we recommended that they suspend advances.

Mr. ROSENTHAL. Then what happened?

Mr. TOTH. Subsequently, we received a letter from Village Mall properties explaining the sewer situation, what was transpiring, and that their engineer was in direct negotiations and discussions with the city and the relative agencies involved to work out the situation.

It indicated in that letter that they were within a week or 2 of getting approval and that in any event there was no problem with sewers for the townhouses alone because the sewer system in 26th Avenue was sufficient to take that project, the townhouses, on its own; and that if there were any problem at all, that this project could be separated from the towers project and tied in directly.

After we received that letter, we notified Washington Federal that we had an answer that was satisfactory to us, that the sewer problem was in effect being worked out. And we had spoken to the engineers for the developers and they indicated the same thing.

Based on that information, we felt that the problem was being resolved and was not a major problem and that advances could be continued.

Mr. ROSENTHAL. Did they ever get a building permit or whatever permits were necessary?

Mr. TOTH. The building permit was issued, I think, in October 1973.

Mr. ROSENTHAL. And you had no further problems with this project whatsoever?

Mr. TOTH. There was no indication to us that there was any other difficulty.

Mr. ROSENTHAL. And all of the permits are in order as of today?

Mr. TOTH. There is no indication to us that there is anything not in order.

Mr. ROSENTHAL. Then somebody could take this project over and proceed to complete it?

Mr. TOTH. We have not been directly involved in it for the last year or year and one-half since the project stopped. We have not been asked to look into anything further. So for the last year, we have not been actively involved in it.

Mr. BROWN. But you haven't answered the chairman's question. He asked: "As of the time that you were in contact with it, did it have any problems; or could it have gone on?"

Mr. TOTH. There were no problems that we were aware of. The only problem that came to our attention was the sewer situation which was when we advised the stopping of disbursement of funds. That was the only thing that had come up.

Mr. BROWN. Assuming the facts are today as they were then, insofar as your activities were concerned, the project could go on to completion.

Mr. TOTH. That is correct.

Mr. BROWN. In the course of your supervising this construction, did anything come to your attention which would indicate to you that this was less than a well-managed or functionally conducted project?

Mr. TOTH. Nothing came to my attention other than the fact that there were complexities involved with the towers and the townhouses projects because of their proximity.

Mr. BROWN. What kinds of problems?

Mr. TOTH. Coordination problems. Some materials from the townhouse site would be stored on the other site. Normally, they would not

be included in our disbursement estimates anyway. So other than coordination problems that would have arisen from two projects of the same developer being so close together, there were no other things indicated to us to be any problem.

Mr. BROWN. You certainly didn't approve for the disbursement of Washington Federal materials delivered to the other job?

Mr. TOTH. No.

Mr. BROWN. When you made a certification of work done and materials on site, they related to the townhouse project and were the subject of the disbursal.

Mr. TOTH. That is right.

And one or two times we were requested to indicate, in addition to the work in place, which is the way we normally report in our reports, stored materials as a separate item. At some of those times, in a couple of instances, there were materials that were represented to be for the townhouses on the towers project site. But they were not included in our certifications. It was just for information.

Mr. BROWN. I have no further questions.

Mr. ROSENTHAL. Did you do any other supervision of any other Newmark and Rosano jobs?

Mr. TOTH. I have never been involved. I am not aware whether Merritt & Harris has been. I don't believe we had. I don't recall.

Mr. ROSENTHAL. But you had been employed by the bank to sort of protect the bank's interest.

Mr. TOTH. That is correct.

Mr. ROSENTHAL. Have you done a lot of work for Washington Federal?

Mr. TOTH. A moderate amount.

Mr. ROSENTHAL. How many projects?

Mr. TOTH. I personally have been involved in maybe two others.

Mr. ROSENTHAL. How about Merritt & Harris?

Mr. TOTH. For Merritt & Harris, I would say that probably not a substantial amount of our work is from Washington Federal—in fact, a minimal amount. We handle projects throughout the country. Two or three percent might have been with Washington Federal.

Mr. ROSENTHAL. Was there anything about this particular project that caused you particular concern?

Mr. TOTH. There was nothing unusual other than what I just stated. The only thing that concerned us was the fact that there was a project by the same developer on an adjacent site which was much larger than our project. That was the only thing that was a concern to us.

Mr. BROWN. Why did that concern you?

Mr. TOTH. Because of coordination problems of work and construction.

Mr. ROSENTHAL. Was there any mechanism whereby you or Washington Federal could have been assured that the disbursement of funds would have been used solely in the construction of the Village Mall project?

Mr. TOTH. We were not involved in the disbursement of funds. We were not involved in monitoring the payments made by the developer to the contractors. So I am not aware of anything that we could have done.

Mr. BROWN. But each time you authorized a disbursement, you determined that that amount of more work had been done, didn't you?

Mr. TOTH. That is correct.

Mr. BROWN. Therefore, there was never any money paid by Washington Federal to the developers that was not on the basis of your certification of work completed.

Mr. TOTH. That is correct. But there is no way we would have known whether the developer took that money and paid the contractors for the work.

Mr. ROSENTHAL. As it turns out, they didn't.

Mr. TOTH. We have heard that from word of mouth. We have no direct knowledge of anything of that sort though.

Mr. BROWN. Our concern is more with Washington Federal than with subcontractors. As far as Washington Federal was concerned, again, to your knowledge was a dime paid out by Washington Federal in the way of disbursement that was not certified as being due upon the basis of work completed on that project?

Mr. TOTH. I have no knowledge of what disbursements were made by Washington Federal. All I know is that we give them a report on what we find to be in place and a percentage of completion. I have no knowledge of what they do with that and how much their disbursements are. We were never advised of when they made disbursements and we never know the amounts of disbursements. We report to them the information of the work that is in place and we are not advised of what they disburse. I cannot make that kind of statement.

All I can say is that if our reports and certifications to them were followed, that would be the case.

Mr. ROSENTHAL. Thank you very much.

Is Mr. Mahon here? If not, the subcommittee stands adjourned. This investigation will continue.

[Whereupon, at 11:45 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]

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